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I Acts whose publication is obligatory

- ★ **Commission Regulation (EC) No 1725/2003 of 29 September 2003 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council ⁽¹⁾** 1

Price: EUR 62,00

⁽¹⁾ Text with EEA relevance.

EN

Acts whose titles are printed in light type are those relating to day-to-day management of agricultural matters, and are generally valid for a limited period.

The titles of all other Acts are printed in bold type and preceded by an asterisk.

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(Acts whose publication is obligatory)

COMMISSION REGULATION (EC) No 1725/2003**of 29 September 2003****adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council****(Text with EEA relevance)**

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards⁽¹⁾, and in particular Article 3(3) thereof,

Whereas:

- (1) Regulation (EC) No 1606/2002 requires that for each financial year starting on or after 1 January 2005, publicly traded companies governed by the law of a Member State shall under certain conditions prepare their consolidated accounts in conformity with international accounting standards as defined in Article 2 of that Regulation.
- (2) The Commission, having considered the advice provided by the Accounting Technical Committee, has concluded that the international accounting standards in existence on 14 September 2002 meet the criteria for adoption set out in Article 3 of Regulation (EC) No 1606/2002.
- (3) The Commission has also considered the current improvements projects that propose to amend many existing standards. International accounting standards resulting from the finalisation of these proposals will be considered for adoption once those standards are final. The existence of these proposed amendments to existing standards does not impact upon the Commission's decision to endorse the existing standards, except in the cases of IAS 32 Financial instruments: disclosure and presentation, IAS 39 Financial instruments: recognition and measurement and a small number of interpretations related to these standards, SIC 5 Classification of financial instruments — Contingent settlement provisions, SIC 16 Share capital — reacquired own equity

instruments (treasury shares) and SIC 17 Equity — Costs of an equity transaction.

- (4) The existence of high quality standards dealing with financial instruments, including derivatives, is important to the Community capital market. However, in the cases of IAS 32 and IAS 39, amendments currently being considered may be so considerable that it is appropriate not to adopt these standards at this time. As soon as the current improvement project is complete and revised standards issued, the Commission will consider, as a matter of priority, the adoption of the revised standards further to Regulation (EC) No 1606/2002.
- (5) Accordingly, all international accounting standards in existence on 14 September 2002 except IAS 32, IAS 39 and the related interpretations should be adopted.
- (6) The measures provided for in this Regulation are in accordance with the opinion of the Accounting Regulatory Committee.

HAS ADOPTED THIS REGULATION,

Article 1

The international accounting standards set out in the Annex are adopted.

Article 2

This Regulation shall enter into force on the third day following its publication in the *Official Journal of the European Union*.

⁽¹⁾ OJ L 243, 11.9.2002, p. 1.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 29 September 2003.

For the Commission
Frederik BOLKESTEIN
Member of the Commission

ANNEX

INTERNATIONAL ACCOUNTING STANDARDS

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Note: Any appendices to those standards and interpretations are not considered as part of those standards and interpretations and shall therefore not be reproduced.

**INTERNATIONAL ACCOUNTING STANDARD IAS 1
(REVISED 1997)****Presentation of financial statements**

This revised International Accounting Standard supersedes IAS 1, disclosure of accounting policies, IAS 5, information to be disclosed in financial statements, and IAS 13, presentation of current assets and current liabilities, which were approved by the Board in reformatted versions in 1994. IAS 1 (revised 1997) was approved by the IASC Board in July 1997 and became effective for financial statements covering periods beginning on or after 1 July 1998.

In May 1999, IAS 10 (revised 1999), events after the balance sheet date, amended paragraphs 63(c), 64, 65(a) and 74(c). The amended text becomes effective when IAS 10 (revised 1999) becomes effective, i.e. for annual financial statements covering periods beginning on or after 1 January 2000.

The following SIC interpretations relate to IAS 1:

- SIC-8: first-time application of IASs as the primary basis of accounting,
- SIC-18: consistency — alternative methods,
- SIC-27: evaluating the substance of transactions in the legal form of a lease,
- SIC-29: disclosure — Service concession arrangements.

Introduction

1. This Standard ('IAS 1 (revised 1997)') replaces International Accounting Standards IAS 1, disclosure of accounting policies, IAS 5, information to be disclosed in financial statements, and IAS 13, presentation of current assets and current liabilities. IAS 1 (revised) is effective for accounting periods beginning on or after 1 July 1998 although, because the requirements are consistent with those in existing Standards, earlier application is encouraged.
2. The Standard updates the requirements in the Standards it replaces, consistent with the IASC framework for the preparation and presentation of financial statements. In addition, it is designed to improve the quality of financial statements presented using International Accounting Standards by:
 - (a) ensuring that financial statements that state compliance with IAS comply with each applicable Standard, including all disclosure requirements;
 - (b) ensuring that departures from IAS requirements are restricted to extremely rare cases (instances of non-compliance will be monitored and further guidance issued when appropriate);
 - (c) providing guidance on the structure of financial statements including minimum requirements for each primary statement, accounting policies and notes, and an illustrative appendix; and
 - (d) establishing (based on the framework) practical requirements on issues such as materiality, going concern, the selection of accounting policies when no Standard exists, consistency and the presentation of comparative information.
3. To deal with users' demands for more comprehensive information on 'performance', measured more broadly than the 'profit' shown in the income statement, the Standard establishes a new requirement for a primary financial statement showing those gains and losses not currently presented in the income statement. The new statement may be presented either as a 'traditional' equity reconciliation in column form, or as a statement of performance in its own right. The IASC Board agreed in principle, in April 1997, to undertake a review of the way in which performance is measured and reported. The project is likely to consider, initially, the interaction between performance reporting and the objectives of reporting in the IASC framework. Therefore, IASC will develop proposals in this area.

IAS 1

4. The Standard applies to all enterprises reporting in accordance with IAS, including banks and insurance companies. The minimum structures are designed to be sufficiently flexible that they can be adapted for use by any enterprise. Banks, for example, should be able to develop a presentation which complies with this Standard and the more detailed requirements in IAS 30, disclosures in the financial statements of banks and similar financial institutions.

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

OBJECTIVE

The objective of this Standard is to prescribe the basis for presentation of general purpose financial statements, in order to ensure comparability both with the enterprise's own financial statements of previous periods and with the financial statements of other enterprises. To achieve this objective, this Standard sets out overall considerations for the presentation of financial statements, guidelines for their structure and minimum requirements for the content of financial statements. The recognition, measurement and disclosure of specific transactions and events is dealt with in other International Accounting Standards.

SCOPE

1. ***This Standard should be applied in the presentation of all general purpose financial statements prepared and presented in accordance with International Accounting Standards.***
2. General purpose financial statements are those intended to meet the needs of users who are not in a position to demand reports tailored to meet their specific information needs. General purpose financial statements include those that are presented separately or within another public document such as an annual report or a prospectus. This Standard does not apply to condensed interim financial information. This Standard applies equally to the financial statements of an individual enterprise and to consolidated financial statements for a group of enterprises. However, it does not preclude the presentation of consolidated financial statements complying with International Accounting Standards and financial statements of the parent company under national requirements within the same document, as long as the basis of preparation of each is clearly disclosed in the statement of accounting policies.
3. This Standard applies to all types of enterprises including banks and insurance enterprises. Additional requirements for banks and similar financial institutions, consistent with the requirements of this Standard, are set out in IAS 30, disclosures in the financial statements of banks and similar financial institutions.
4. This Standard uses terminology that is suitable for an enterprise with a profit objective. Public sector business enterprises may therefore apply the requirements of this Standard. Non-profit, government and other public sector enterprises seeking to apply this Standard may need to amend the descriptions used for certain line items in the financial statements and for the financial statements themselves. Such enterprises may also present additional components of the financial statements.

IAS 1

PURPOSE OF FINANCIAL STATEMENTS

5. Financial statements are a structured financial representation of the financial position of and the transactions undertaken by an enterprise. The objective of general purpose financial statements is to provide information about the financial position, performance and cash flows of an enterprise that is useful to a wide range of users in making economic decisions. Financial statements also show the results of management's stewardship of the resources entrusted to it. To meet this objective, financial statements provide information about an enterprise's:
- (a) assets;
 - (b) liabilities;
 - (c) equity;
 - (d) income and expenses, including gains and losses; and
 - (e) cash flows.

This information, along with other information in the notes to financial statements, assists users in predicting the enterprise's future cash flows and in particular the timing and certainty of the generation of cash and cash equivalents.

RESPONSIBILITY FOR FINANCIAL STATEMENTS

6. The board of directors and/or other governing body of an enterprise is responsible for the preparation and presentation of its financial statements.

COMPONENTS OF FINANCIAL STATEMENTS

7. ***A complete set of financial statements includes the following components:***
- (a) ***balance sheet;***
 - (b) ***income statement;***
 - (c) ***a statement showing either:***
 - (i) ***all changes in equity; or***
 - (ii) ***changes in equity other than those arising from capital transactions with owners and distributions to owners;***
 - (d) ***cash flow statement; and***
 - (e) ***accounting policies and explanatory notes.***
8. Enterprises are encouraged to present, outside the financial statements, a financial review by management which describes and explains the main features of the enterprise's financial performance and financial position and the principal uncertainties it faces. Such a report may include a review of:
- (a) the main factors and influences determining performance, including changes in the environment in which the enterprise operates, the enterprise's response to those changes and their effect, and the enterprise's policy for investment to maintain and enhance performance, including its dividend policy;
 - (b) the enterprise's sources of funding, the policy on gearing and its risk management policies; and
 - (c) the strengths and resources of the enterprise whose value is not reflected in the balance sheet under International Accounting Standards.

9. Many enterprises present, outside the financial statements, additional statements such as environmental reports and value added statements, particularly in industries where environmental factors are significant and when employees are considered to be an important user group. Enterprises are encouraged to present such additional statements if management believes they will assist users in making economic decisions.

OVERALL CONSIDERATIONS

Fair presentation and compliance with international accounting standards

10. ***Financial statements should present fairly the financial position, financial performance and cash flows of an enterprise. The appropriate application of International Accounting Standards, with additional disclosure when necessary, results, in virtually all circumstances, in financial statements that achieve a fair presentation.***
11. ***An enterprise whose financial statements comply with International Accounting Standards should disclose that fact. Financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable Standard and each applicable interpretation of the Standing Interpretations Committee ⁽¹⁾.***
12. ***Inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used or by notes or explanatory material.***
13. ***In the extremely rare circumstances when management concludes that compliance with a requirement in a Standard would be misleading, and therefore that departure from a requirement is necessary to achieve a fair presentation, an enterprise should disclose:***
- (a) ***that management has concluded that the financial statements fairly present the enterprise's financial position, financial performance and cash flows;***
 - (b) ***that it has complied in all material respects with applicable International Accounting Standards except that it has departed from a Standard in order to achieve a fair presentation;***
 - (c) ***the Standard from which the enterprise has departed, the nature of the departure, including the treatment that the Standard would require, the reason why that treatment would be misleading in the circumstances and the treatment adopted; and***
 - (d) ***the financial impact of the departure on the enterprise's net profit or loss, assets, liabilities, equity and cash flows for each period presented.***
14. Financial statements have sometimes been described as being 'based on' or 'complying with the significant requirements of' or 'in compliance with the accounting requirements of International Accounting Standards. Often there is no further information, although it is clear that significant disclosure requirements, if not accounting requirements, are not met. Such statements are misleading because they detract from the reliability and understandability of the financial statements. In order to ensure that financial statements that state compliance with International Accounting Standards will meet the standard required by users internationally, this Standard includes an overall requirement that financial statements should give a fair presentation, guidance on how the fair presentation requirement is met, and further guidance for determining the extremely rare circumstances when a departure is necessary. It also requires prominent disclosure of the circumstances surrounding a departure. The existence of conflicting national requirements is not, in itself, sufficient to justify a departure in financial statements prepared using International Accounting Standards.

⁽¹⁾ See also SIC-8: first-time application of IASs as the primary basis of accounting.

IAS 1

15. In virtually all circumstances, a fair presentation is achieved by compliance in all material respects with applicable International Accounting Standards. A fair presentation requires:
- (a) selecting and applying accounting policies in accordance with paragraph 20;
 - (b) presenting information, including accounting policies, in a manner which provides relevant, reliable, comparable and understandable information; and
 - (c) providing additional disclosures when the requirements in International Accounting Standards are insufficient to enable users to understand the impact of particular transactions or events on the enterprise's financial position and financial performance.
16. In extremely rare circumstances, application of a specific requirement in an International Accounting Standard might result in misleading financial statements. This will be the case only when the treatment required by the Standard is clearly inappropriate and thus a fair presentation cannot be achieved either by applying the Standard or through additional disclosure alone. Departure is not appropriate simply because another treatment would also give a fair presentation.
17. When assessing whether a departure from a specific requirement in International Accounting Standards is necessary, consideration is given to:
- (a) the objective of the requirement and why that objective is not achieved or is not relevant in the particular circumstances; and
 - (b) the way in which the enterprise's circumstances differ from those of other enterprises which follow the requirement.
18. Because the circumstances requiring a departure are expected to be extremely rare and the need for a departure will be a matter for considerable debate and subjective judgement, it is important that users are aware that the enterprise has not complied in all material respects with International Accounting Standards. It is also important that they are given sufficient information to enable them to make an informed judgement on whether the departure is necessary and to calculate the adjustments that would be required to comply with the Standard. IASC will monitor instances of non-compliance that are brought to its attention (by enterprises, their auditors and regulators, for example) and will consider the need for clarification through interpretations or amendments to Standards, as appropriate, to ensure that departures remain necessary only in extremely rare circumstances.
19. ***When, in accordance with specific provisions in that Standard, an International Accounting Standard is applied before its effective date, that fact should be disclosed.***

ACCOUNTING POLICIES

20. ***Management should select and apply an enterprise's accounting policies so that the financial statements comply with all the requirements of each applicable International Accounting Standard and interpretation of the Standing Interpretations Committee. Where there is no specific requirement, management should develop policies to ensure that the financial statements provide information that is:***
- (a) ***relevant to the decision-making needs of users; and***
 - (b) ***reliable in that they:***
 - (i) ***represent faithfully the results and financial position of the enterprise;***

- (ii) *reflect the economic substance of events and transactions and not merely the legal form* ⁽²⁾;
 - (iii) *are neutral, that is free from bias;*
 - (iv) *are prudent; and*
 - (v) *are complete in all material respects.*
21. Accounting policies are the specific principles, bases, conventions, rules and practices adopted by an enterprise in preparing and presenting financial statements.
22. In the absence of a specific International Accounting Standard and an interpretation of the Standing Interpretations Committee, management uses its judgement in developing an accounting policy that provides the most useful information to users of the enterprise's financial statements. In making this judgement, management considers:
- (a) the requirements and guidance in International Accounting Standards dealing with similar and related issues;
 - (b) the definitions, recognition and measurement criteria for assets, liabilities, income and expenses set out in the IASC framework; and
 - (c) pronouncements of other standard setting bodies and accepted industry practices to the extent, but only to the extent, that these are consistent with (a) and (b) of this paragraph.

GOING CONCERN

23. ***When preparing financial statements, management should make an assessment of an enterprise's ability to continue as a going concern. Financial statements should be prepared on a going concern basis unless management either intends to liquidate the enterprise or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions which may cast significant doubt upon the enterprise's ability to continue as a going concern, those uncertainties should be disclosed. When the financial statements are not prepared on a going concern basis, that fact should be disclosed, together with the basis on which the financial statements are prepared and the reason why the enterprise is not considered to be a going concern.***
24. In assessing whether the going concern assumption is appropriate, management takes into account all available information for the foreseeable future, which should be at least, but is not limited to, 12 months from the balance sheet date. The degree of consideration depends on the facts in each case. When an enterprise has a history of profitable operations and ready access to financial resources, a conclusion that the going concern basis of accounting is appropriate may be reached without detailed analysis. In other cases, management may need to consider a wide range of factors surrounding current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

ACCRUAL BASIS OF ACCOUNTING

25. ***An enterprise should prepare its financial statements, except for cash flow information, under the accrual basis of accounting.***

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

IAS 1

26. Under the accrual basis of accounting, transactions and events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. Expenses are recognised in the income statement on the basis of a direct association between the costs incurred and the earning of specific items of income (matching). However, the application of the matching concept does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.

CONSISTENCY OF PRESENTATION

27. ***The presentation and classification of items in the financial statements should be retained from one period to the next unless:***
- (a) ***a significant change in the nature of the operations of the enterprise or a review of its financial statement presentation demonstrates that the change will result in a more appropriate presentation of events or transactions; or***
 - (b) ***a change in presentation is required by an International Accounting Standard or an interpretation of the Standing Interpretations Committee*** ⁽³⁾.
28. A significant acquisition or disposal, or a review of the financial statement presentation, might suggest that the financial statements should be presented differently. Only if the revised structure is likely to continue, or if the benefit of an alternative presentation is clear, should an enterprise change the presentation of its financial statements. When such changes in presentation are made, an enterprise reclassifies its comparative information in accordance with paragraph 38. A change in presentation to comply with national requirements is permitted as long as the revised presentation is consistent with the requirements of this Standard.

MATERIALITY AND AGGREGATION

29. ***Each material item should be presented separately in the financial statements. Immaterial amounts should be aggregated with amounts of a similar nature or function and need not be presented separately.***
30. Financial statements result from processing large quantities of transactions which are structured by being aggregated into groups according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data which form line items either on the face of the financial statements or in the notes. If a line item is not individually material, it is aggregated with other items either on the face of the financial statements or in the notes. An item that is not sufficiently material to warrant separate presentation on the face of the financial statements may nevertheless be sufficiently material that it should be presented separately in the notes.
31. In this context, information is material if its non-disclosure could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the item judged in the particular circumstances of its omission. In deciding whether an item or an aggregate of items is material, the nature and the size of the item are evaluated together. Depending on the circumstances, either the nature or the size of the item could be the determining factor. For example, individual assets with the same nature and function are aggregated even if the individual amounts are large. However, large items which differ in nature or function are presented separately.
32. Materiality provides that the specific disclosure requirements of International Accounting Standards need not be met if the resulting information is not material.

⁽³⁾ See also SIC-18: consistency — alternative methods.

OFFSETTING

33. ***Assets and liabilities should not be offset except when offsetting is required or permitted by another International Accounting Standard.***
34. ***Items of income and expense should be offset when, and only when:***
- (a) ***an International Accounting Standard requires or permits it; or***
 - (b) ***gains, losses and related expenses arising from the same or similar transactions and events are not material. Such amounts should be aggregated in accordance with paragraph 29.***
35. It is important that both assets and liabilities, and income and expenses, when material, are reported separately. Offsetting in either the income statement or the balance sheet, except when offsetting reflects the substance of the transaction or event, detracts from the ability of users to understand the transactions undertaken and to assess the future cash flows of the enterprise. The reporting of assets net of valuation allowances, for example obsolescence allowances on inventories and doubtful debts allowances on receivables, is not offsetting.
36. IAS 18, revenue, defines the term revenue and requires it to be measured at the fair value of consideration received or receivable, taking into account the amount of any trade discounts and volume rebates allowed by the enterprise. An enterprise undertakes, in the course of its ordinary activities, other transactions which do not generate revenue but which are incidental to the main revenue generating activities. The results of such transactions are presented, when this presentation reflects the substance of the transaction or event, by netting any income with related expenses arising on the same transaction. For example:
- (a) gains and losses on the disposal of non-current assets, including investments and operating assets, are reported by deducting from the proceeds on disposal the carrying amount of the asset and related selling expenses;
 - (b) expenditure that is reimbursed under a contractual arrangement with a third party (a sub-letting agreement, for example) is netted against the related reimbursement; and
 - (c) extraordinary items may be presented net of related taxation and minority interest with the gross amounts shown in the notes.
37. In addition, gains and losses arising from a group of similar transactions are reported on a net basis, for example foreign exchange gains and losses or gains and losses arising on financial instruments held for trading purposes. Such gains and losses are, however, reported separately if their size, nature or incidence is such that separate disclosure is required by IAS 8, Net profit or loss for the period, fundamental errors and changes in accounting policies.

COMPARATIVE INFORMATION

38. ***Unless an International Accounting Standard permits or requires otherwise, comparative information should be disclosed in respect of the previous period for all numerical information in the financial statements. Comparative information should be included in narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.***
39. In some cases narrative information provided in the financial statements for the previous period(s) continues to be relevant in the current period. For example, details of a legal dispute, the outcome of which was uncertain at the last balance sheet date and is yet to be resolved, are disclosed in the current period. Users benefit from information that the uncertainty existed at the last balance sheet date, and the steps that have been taken during the period to resolve the uncertainty.

IAS 1

40. ***When the presentation or classification of items in the financial statements is amended, comparative amounts should be reclassified, unless it is impracticable to do so, to ensure comparability with the current period, and the nature, amount of, and reason for, any reclassification should be disclosed. When it is impracticable to reclassify comparative amounts, an enterprise should disclose the reason for not reclassifying and the nature of the changes that would have been made if amounts were reclassified.***
41. Circumstances may exist when it is impracticable to reclassify comparative information to achieve comparability with the current period. For example, data may not have been collected in the previous period(s) in a way which allows reclassification, and it may not be practicable to recreate the information. In such circumstances, the nature of the adjustments to comparative amounts that would have been made are disclosed. IAS 8 deals with the adjustments required to comparative information following a change in accounting policy that is applied retrospectively.

STRUCTURE AND CONTENT

Introduction

42. This Standard requires certain disclosures on the face of the financial statements, requires other line items to be disclosed either on the face of the financial statements or in the notes, and sets out recommended formats as an appendix to the Standard which an enterprise may follow as appropriate in its own circumstances. IAS 7 provides a structure for the presentation of the cash flow statement.
43. This Standard uses the term disclosure in a broad sense, encompassing items presented on the face of each financial statement as well as in the notes to the financial statements. Disclosures required by other International Accounting Standards are made in accordance with the requirements of those Standards. Unless this or another Standard specifies to the contrary, such disclosures are made either on the face of the relevant financial statement or in the notes.

Identification of financial statements

44. ***Financial statements should be clearly identified and distinguished from other information in the same published document.***
45. International Accounting Standards apply only to the financial statements, and not to other information presented in an annual report or other document. Therefore, it is important that users are able to distinguish information that is prepared using International Accounting Standards from other information which may be useful to users but is not the subject of Standards.
46. ***Each component of the financial statements should be clearly identified. In addition, the following information should be prominently displayed, and repeated when it is necessary for a proper understanding of the information presented:***
- (a) ***the name of the reporting enterprise or other means of identification;***
 - (b) ***whether the financial statements cover the individual enterprise or a group of enterprises;***
 - (c) ***the balance sheet date or the period covered by the financial statements, whichever is appropriate to the related component of the financial statements;***
 - (d) ***the reporting currency; and***
 - (e) ***the level of precision used in the presentation of figures in the financial statements.***
47. The requirements in paragraph 46 are normally met by presenting page headings and abbreviated column headings on each page of the financial statements. Judgement is required in determining the best way of presenting such information. For example, when the financial statements are read electronically, separate pages may not be used; the above items are then presented frequently enough to ensure a proper understanding of the information given.

48. Financial statements are often made more understandable by presenting information in thousands or millions of units of the reporting currency. This is acceptable as long as the level of precision in presentation is disclosed and relevant information is not lost.

Reporting period

49. **Financial statements should be presented at least annually. When, in exceptional circumstances, an enterprise's balance sheet date changes and annual financial statements are presented for a period longer or shorter than one year, an enterprise should disclose, in addition to the period covered by the financial statements:**
- (a) **the reason for a period other than one year being used; and**
 - (b) **the fact that comparative amounts for the income statement, changes in equity, cash flows and related notes are not comparable.**
50. In exceptional circumstances an enterprise may be required to, or decide to, change its balance sheet date, for example following the acquisition of the enterprise by another enterprise with a different balance sheet date. When this is the case, it is important that users are aware that the amounts shown for the current period and comparative amounts are not comparable and that the reason for the change in balance sheet date is disclosed.
51. Normally, financial statements are consistently prepared covering a one year period. However, some enterprises prefer to report, for example, for a 52 week period for practical reasons. This Standard does not preclude this practice, as the resulting financial statements are unlikely to be materially different to those that would be presented for one year.

Timeliness

52. The usefulness of financial statements is impaired if they are not made available to users within a reasonable period after the balance sheet date. An enterprise should be in a position to issue its financial statements within six months of the balance sheet date. Ongoing factors such as the complexity of an enterprise's operations are not sufficient reason for failing to report on a timely basis. More specific deadlines are dealt with by legislation and market regulation in many jurisdictions.

Balance sheet

The current/non-current distinction

53. **Each enterprise should determine, based on the nature of its operations, whether or not to present current and non-current assets and current and non-current liabilities as separate classifications on the face of the balance sheet. Paragraphs 57 to 65 of this Standard apply when this distinction is made. When an enterprise chooses not to make this classification, assets and liabilities should be presented broadly in order of their liquidity.**
54. **Whichever method of presentation is adopted, an enterprise should disclose, for each asset and liability item that combines amounts expected to be recovered or settled both before and after 12 months from the balance sheet date, the amount expected to be recovered or settled after more than 12 months.**
55. When an enterprise supplies goods or services within a clearly identifiable operating cycle, separate classification of current and non-current assets and liabilities on the face of the balance sheet provides useful information by distinguishing the net assets that are continuously circulating as working capital from those used in the enterprise's long-term operations. It also highlights assets that are expected to be realised within the current operating cycle, and liabilities that are due for settlement within the same period.

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56. Information about the maturity dates of assets and liabilities is useful in assessing the liquidity and solvency of an enterprise. IAS 32, financial instruments: disclosure and presentation, requires disclosure of the maturity dates of both financial assets and financial liabilities. Financial assets include trade and other receivables and financial liabilities include trade and other payables. Information on the expected date of recovery and settlement of non-monetary assets and liabilities such as inventories and provisions is also useful whether or not assets and liabilities are classified between current and non-current. For example, an enterprise discloses the amount of inventories which are expected to be recovered after more than one year from the balance sheet date.

Current assets

57. ***An asset should be classified as a current asset when it:***
- (a) ***is expected to be realised in, or is held for sale or consumption in, the normal course of the enterprise's operating cycle; or***
 - (b) ***is held primarily for trading purposes or for the short-term and expected to be realised within 12 months of the balance sheet date; or***
 - (c) ***is cash or a cash equivalent asset which is not restricted in its use.***

All other assets should be classified as non-current assets.

58. This Standard uses the term 'non-current' to include tangible, intangible, operating and financial assets of a long-term nature. It does not prohibit the use of alternative descriptions as long as the meaning is clear.
59. The operating cycle of an enterprise is the time between the acquisition of materials entering into a process and its realisation in cash or an instrument that is readily convertible into cash. Current assets include inventories and trade receivables that are sold, consumed and realised as part of the normal operating cycle even when they are not expected to be realised within 12 months of the balance sheet date. Marketable securities are classified as current assets if they are expected to be realised within 12 months of the balance sheet date; otherwise they are classified as non-current assets.

Current liabilities

60. ***A liability should be classified as a current liability when it:***
- (a) ***is expected to be settled in the normal course of the enterprise's operating cycle; or***
 - (b) ***is due to be settled within 12 months of the balance sheet date.***

All other liabilities should be classified as non-current liabilities.

61. Current liabilities can be categorised in a similar way to current assets. Some current liabilities, such as trade payables and accruals for employee and other operating costs, form part of the working capital used in the normal operating cycle of the business. Such operating items are classified as current liabilities even if they are due to be settled after more than 12 months from the balance sheet date.
62. Other current liabilities are not settled as part of the current operating cycle, but are due for settlement within 12 months of the balance sheet date. Examples are the current portion of interest-bearing liabilities, bank overdrafts, dividends payable, income taxes and other non-trade payables. Interest-bearing liabilities that provide the financing for working capital on a long-term basis, and are not due for settlement within 12 months, are non-current liabilities.

63. **An enterprise should continue to classify its long-term interest-bearing liabilities as non-current, even when they are due to be settled within 12 months of the balance sheet date if:**
- (a) **the original term was for a period of more than 12 months;**
 - (b) **the enterprise intends to refinance the obligation on a long-term basis; and**
 - (c) **that intention is supported by an agreement to refinance, or to reschedule payments, which is completed before the financial statements are authorised for issue.**

The amount of any liability that has been excluded from current liabilities in accordance with this paragraph, together with information in support of this presentation, should be disclosed in the notes to the balance sheet.

64. Some obligations that are due to be repaid within the next operating cycle may be expected to be refinanced or 'rolled over' at the discretion of the enterprise and, therefore, are not expected to use current working capital of the enterprise. Such obligations are considered to form part of the enterprise's long-term financing and should be classified as non-current. However, in situations in which refinancing is not at the discretion of the enterprise (as would be the case if there were no agreement to refinance), the refinancing cannot be considered automatic and the obligation is classified as current unless the completion of a refinancing agreement before authorisation of the financial statements for issue provides evidence that the substance of the liability at the balance sheet date was long-term.
65. Some borrowing agreements incorporate undertakings by the borrower (covenants) which have the effect that the liability becomes payable on demand if certain conditions related to the borrower's financial position are breached. In these circumstances, the liability is classified as non-current only when:
- (a) the lender has agreed, prior to the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach; and
 - (b) it is not probable that further breaches will occur within 12 months of the balance sheet date.

Information to be presented on the face of the balance sheet

66. **As a minimum, the face of the balance sheet should include line items which present the following amounts:**
- (a) **property, plant and equipment;**
 - (b) **intangible assets;**
 - (c) **financial assets (excluding amounts shown under (d), (f) and (g));**
 - (d) **investments accounted for using the equity method;**
 - (e) **inventories;**
 - (f) **trade and other receivables;**
 - (g) **cash and cash equivalents;**
 - (h) **trade and other payables;**
 - (i) **tax liabilities and assets as required by IAS 12, income taxes;**
 - (j) **provisions;**
 - (k) **non-current interest-bearing liabilities;**
 - (l) **minority interest; and**
 - (m) **issued capital and reserves.**

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67. ***Additional line items, headings and sub-totals should be presented on the face of the balance sheet when an International Accounting Standard requires it, or when such presentation is necessary to present fairly the enterprise's financial position.***
68. This Standard does not prescribe the order or format in which items are to be presented. Paragraph 66 simply provides a list of items that are so different in nature or function that they deserve separate presentation on the face of the balance sheet. Illustrative formats are set out in the Appendix to this Standard. Adjustments to the line items above include the following:
- (a) line items are added when another International Accounting Standard requires separate presentation on the face of the balance sheet, or when the size, nature or function of an item is such that separate presentation would assist in presenting fairly the enterprise's financial position; and
 - (b) the descriptions used and the ordering of items may be amended according to the nature of the enterprise and its transactions, to provide information that is necessary for an overall understanding of the enterprise's financial position. For example, a bank amends the above descriptions in order to apply the more specific requirements in paragraphs 18 to 25 of IAS 30, disclosures in the financial statements of banks and similar financial institutions.
69. The line items listed in paragraph 66 are broad in nature and need not be limited to items falling within the scope of other Standards. For example, the line item intangible assets includes goodwill and assets arising from development expenditure.
70. The judgement on whether additional items are separately presented is based on an assessment of:
- (a) the nature and liquidity of assets and their materiality, leading, in most cases, to the separate presentation of, goodwill and assets arising from development expenditure, monetary and non-monetary assets and current and non-current assets;
 - (b) their function within the enterprise, leading, for example, to the separate presentation of operating and financial assets, inventories, receivables and cash and cash equivalent assets; and
 - (c) the amounts, nature and timing of liabilities, leading, for example, to the separate presentation of interest-bearing and non-interest-bearing liabilities and provisions, classified as current or non-current if appropriate.
71. Assets and liabilities that differ in nature or function are sometimes subject to different measurement bases. For example certain classes of property, plant and equipment may be carried at cost, or at revalued amounts in accordance with IAS 16. The use of different measurement bases for different classes of assets suggests that their nature or function differs and therefore that they should be presented as separate line items.

Information to be presented either on the face of the balance sheet or in the notes

72. ***An enterprise should disclose, either on the face of the balance sheet or in the notes to the balance sheet, further sub-classifications of the line items presented, classified in a manner appropriate to the enterprise's operations. Each item should be sub-classified, when appropriate, by its nature and, amounts payable to and receivable from the parent enterprise, fellow subsidiaries and associates and other related parties should be disclosed separately.***

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73. The detail provided in sub-classifications, either on the face of the balance sheet or in the notes, depends on the requirements of International Accounting Standards and the size, nature and function of the amounts involved. The factors set out in paragraph 70 are also used to decide the basis of sub-classification. The disclosures will vary for each item, for example:
- (a) tangible assets are classified by class as described in IAS 16, property, plant and equipment;
 - (b) receivables are analysed between amounts receivable from trade customers, other members of the group, receivables from related parties, prepayments and other amounts;
 - (c) inventories are sub-classified, in accordance with IAS 2, inventories, into classifications such as merchandise, production supplies, materials, work in progress and finished goods;
 - (d) provisions are analysed showing separately provisions for employee benefit costs and any other items classified in a manner appropriate to the enterprise's operations; and
 - (e) equity capital and reserves are analysed showing separately the various classes of paid in capital, share premium and reserves.
74. **An enterprise should disclose the following, either on the face of the balance sheet or in the notes:**
- (a) **for each class of share capital:**
 - (i) **the number of shares authorised;**
 - (ii) **the number of shares issued and fully paid, and issued but not fully paid;**
 - (iii) **par value per share, or that the shares have no par value;**
 - (iv) **a reconciliation of the number of shares outstanding at the beginning and at the end of the year;**
 - (v) **the rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital;**
 - (vi) **shares in the enterprise held by the enterprise itself or by subsidiaries or associates of the enterprise; and**
 - (vii) **shares reserved for issuance under options and sales contracts, including the terms and amounts;**
 - (b) **a description of the nature and purpose of each reserve within owners' equity;**
 - (c) **the amount of dividends that were proposed or declared after the balance sheet date but before the financial statements were authorised for issue; and**
 - (d) **the amount of any cumulative preference dividends not recognised.**

An enterprise without share capital, such as a partnership, should disclose information equivalent to that required above, showing movements during the period in each category of equity interest and the rights, preferences and restrictions attaching to each category of equity interest.

Income statement

Information to be presented on the face of the income statement

75. **As a minimum, the face of the income statement should include line items which present the following amounts:**
- (a) **revenue;**
 - (b) **the results of operating activities;**
 - (c) **finance costs;**

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- (d) *share of profits and losses of associates and joint ventures accounted for using the equity method;*
- (e) *tax expense;*
- (f) *profit or loss from ordinary activities;*
- (g) *extraordinary items;*
- (h) *minority interest; and*
- (i) *net profit or loss for the period.*

Additional line items, headings and sub-totals should be presented on the face of the income statement when required by an International Accounting Standard, or when such presentation is necessary to present fairly the enterprise's financial performance.

76. The effects of an enterprise's various activities, transactions and events differ in stability, risk and predictability, and the disclosure of the elements of performance assists in an understanding of the performance achieved and in assessing future results. Additional line items are included on the face of the income statement and the descriptions used and the ordering of items are amended when this is necessary to explain the elements of performance. Factors to be taken into consideration include materiality and the nature and function of the various components of income and expenses. For example, a bank amends the descriptions in order to apply the more specific requirements in paragraphs 9 to 17 of IAS 30. Income and expense items are offset only when the criteria in paragraph 34 are met.

Information to be presented either on the face of the income statement or in the notes

77. ***An enterprise should present, either on the face of the income statement or in the notes to the income statement, an analysis of expenses using a classification based on either the nature of expenses or their function within the enterprise.***
78. Enterprises are encouraged to present the analysis in paragraph 77 on the face of the income statement.
79. Expense items are further sub-classified in order to highlight a range of components of financial performance which may differ in terms of stability, potential for gain or loss and predictability. This information is provided in one of two ways.
80. The first analysis is referred to as the nature of expense method. Expenses are aggregated in the income statement according to their nature, (for example depreciation, purchases of materials, transport costs, wages and salaries, advertising costs), and are not reallocated amongst various functions within the enterprise. This method is simple to apply in many smaller enterprises because no allocations of operating expenses between functional classifications is necessary. An example of a classification using the nature of expense method is as follows:

Revenue		X
Other operating income		X
Changes in inventories of finished goods and work in progress	X	
Raw materials and consumables used	X	
Staff costs	X	
Depreciation and amortisation expense	X	
Other operating expenses	X	
		<hr/>
Total operating expenses		(X)
		<hr/>
Profit from operating activities		X
		<hr/> <hr/>

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81. The change in finished goods and work in progress during the period represents an adjustment to production expenses to reflect the fact that either production has increased inventory levels or that sales in excess of production have reduced inventory levels. In some jurisdictions, an increase in finished goods and work in progress during the period is presented immediately following revenue in the above analysis. However, the presentation used should not imply that such amounts represent income.
82. The second analysis is referred to as the function of expense or 'cost of sales' method and classifies expenses according to their function as part of cost of sales, distribution or administrative activities. This presentation often provides more relevant information to users than the classification of expenses by nature, but the allocation of costs to functions can be arbitrary and involves considerable judgement. An example of a classification using the function of expense method is as follows:

Revenue	X
Cost of sales	(X)
	<hr/>
Gross profit	X
Other operating income	X
Distribution costs	(X)
Administrative expenses	(X)
Other operating expenses	(X)
	<hr/>
Profit from operating activities	X
	<hr/> <hr/>

83. ***Enterprises classifying expenses by function should disclose additional information on the nature of expenses, including depreciation and amortisation expense and staff costs.***
84. The choice of analysis between the cost of sales method and the nature of expenditure method depends on both historical and industry factors and the nature of the organisation. Both methods provide an indication of those costs which might be expected to vary, directly or indirectly, with the level of sales or production of the enterprise. Because each method of presentation has merit for different types of enterprise, this Standard requires a choice between classifications based on that which most fairly presents the elements of the enterprise's performance. However, because information on the nature of expenses is useful in predicting future cash flows, additional disclosure is required when the cost of sales classification is used.
85. ***An enterprise should disclose, either on the face of the income statement or in the notes, the amount of dividends per share, declared or proposed, for the period covered by the financial statements.***

CHANGES IN EQUITY

86. ***An enterprise should present, as a separate component of its financial statements, a statement showing:***
- (a) ***the net profit or loss for the period;***
 - (b) ***each item of income and expense, gain or loss which, as required by other Standards, is recognised directly in equity, and the total of these items; and***
 - (c) ***the cumulative effect of changes in accounting policy and the correction of fundamental errors dealt with under the Benchmark treatments in IAS 8.***

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In addition, an enterprise should present, either within this statement or in the notes:

- (d) *capital transactions with owners and distributions to owners;*
 - (e) *the balance of accumulated profit or loss at the beginning of the period and at the balance sheet date, and the movements for the period; and*
 - (f) *a reconciliation between the carrying amount of each class of equity capital, share premium and each reserve at the beginning and the end of the period, separately disclosing each movement.*
87. Changes in an enterprise's equity between two balance sheet dates reflect the increase or decrease in its net assets or wealth during the period, under the particular measurement principles adopted and disclosed in the financial statements. Except for changes resulting from transactions with shareholders, such as capital contributions and dividends, the overall change in equity represents the total gains and losses generated by the enterprise's activities during the period.
88. IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies, requires all items of income and expense recognised in a period to be included in the determination of net profit or loss for the period unless an International Accounting Standard requires or permits otherwise. Other Standards require gains and losses, such as revaluation surpluses and deficits and certain foreign exchange differences, to be recognised directly as changes in equity along with capital transactions with and distributions to the enterprise's owners. Since it is important to take into consideration all gains and losses in assessing the changes in an enterprise's financial position between two balance sheet dates, this Standard requires a separate component of the financial statements which highlights an enterprise's total gains and losses, including those that are recognised directly in equity.
89. The requirements in paragraph 86 may be met in a number of ways. The approach adopted in many jurisdictions follows a columnar format which reconciles between the opening and closing balances of each element within shareholders' equity, including items (a) to (f). An alternative is to present a separate component of the financial statements which presents only items (a) to (c). Under this approach, the items described in (d) to (f) are shown in the notes to the financial statements. Both approaches are illustrated in the appendix to this Standard. Whichever approach is adopted, paragraph 86 requires a sub-total of the items in (b) to enable users to derive the total gains and losses arising from the enterprise's activities during the period.

Cash flow statement

90. IAS 7 sets out requirements for the presentation of the cash flow statement and related disclosures. It states that cash flow information is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilise those cash flows.

Notes to the financial statements

Structure

91. *The notes to the financial statements of an enterprise should:*
- (a) *present information about the basis of preparation of the financial statements and the specific accounting policies selected and applied for significant transactions and events;*
 - (b) *disclose the information required by International Accounting Standards that is not presented elsewhere in the financial statements; and*
 - (c) *provide additional information which is not presented on the face of the financial statements but that is necessary for a fair presentation* ⁽⁴⁾.
92. *Notes to the financial statements should be presented in a systematic manner. Each item on the face of the balance sheet, income statement and cash flow statement should be cross-referenced to any related information in the notes.*

⁽⁴⁾ See also SIC-29: disclosure — service concession arrangements.

93. Notes to the financial statements include narrative descriptions or more detailed analyses of amounts shown on the face of the balance sheet, income statement, cash flow statement and statement of changes in equity, as well as additional information such as contingent liabilities and commitments. They include information required and encouraged to be disclosed by International Accounting Standards, and other disclosures necessary to achieve a fair presentation.
94. Notes are normally presented in the following order which assists users in understanding the financial statements and comparing them with those of other enterprises:
- (a) statement of compliance with International Accounting Standards (see paragraph 11);
 - (b) statement of the measurement basis (bases) and accounting policies applied;
 - (c) supporting information for items presented on the face of each financial statement in the order in which each line item and each financial statement is presented; and
 - (d) other disclosures, including:
 - (i) contingencies, commitments and other financial disclosures; and
 - (ii) non-financial disclosures.
95. In some circumstances, it may be necessary or desirable to vary the ordering of specific items within the notes. For example, information on interest rates and fair value adjustments may be combined with information on maturities of financial instruments although the former are income statement disclosures and the latter relate to the balance sheet. Nevertheless, a systematic structure for the notes is retained as far as practicable.
96. Information about the basis of preparation of the financial statements and specific accounting policies may be presented as a separate component of the financial statements.

Presentation of accounting policies

97. ***The accounting policies section of the notes to the financial statements should describe the following:***
- (a) ***the measurement basis (or bases) used in preparing the financial statements; and***
 - (b) ***each specific accounting policy that is necessary for a proper understanding of the financial statements.***
98. In addition to the specific accounting policies used in the financial statements, it is important for users to be aware of the measurement basis (bases) used (historical cost, current cost, realisable value, fair value or present value) because they form the basis on which the whole of the financial statements are prepared. When more than one measurement basis is used in the financial statements, for example when certain non-current assets are revalued, it is sufficient to provide an indication of the categories of assets and liabilities to which each measurement basis is applied.
99. In deciding whether a specific accounting policy should be disclosed, management considers whether disclosure would assist users in understanding the way in which transactions and events are reflected in the reported performance and financial position. The accounting policies that an enterprise might consider presenting include, but are not restricted to, the following:
- (a) revenue recognition;
 - (b) consolidation principles, including subsidiaries and associates;
 - (c) business combinations;
 - (d) joint ventures;
 - (e) recognition and depreciation/amortisation of tangible and intangible assets;
 - (f) capitalisation of borrowing costs and other expenditure;

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- (g) construction contracts;
- (h) investment properties;
- (i) financial instruments and investments;
- (j) leases;
- (k) research and development costs;
- (l) inventories;
- (m) taxes, including deferred taxes;
- (n) provisions;
- (o) employee benefit costs;
- (p) foreign currency translation and hedging;
- (q) definition of business and geographical segments and the basis for allocation of costs between segments;
- (r) definition of cash and cash equivalents;
- (s) inflation accounting; and
- (t) government grants.

Other International Accounting Standards specifically require disclosure of accounting policies in many of these areas.

100. Each enterprise considers the nature of its operations and the policies which the user would expect to be disclosed for that type of enterprise. For example, all private sector enterprises would be expected to disclose an accounting policy for income taxes, including deferred taxes and tax assets. When an enterprise has significant foreign operations or transactions in foreign currencies, disclosure of accounting policies for the recognition of foreign exchange gains and losses and the hedging of such gains and losses would be expected. In consolidated financial statements, the policy used for determining goodwill and minority interest is disclosed.
101. An accounting policy may be significant even if amounts shown for current and prior periods are not material. It is also appropriate to disclose an accounting policy for each policy not covered by existing International Accounting Standards, but selected and applied in accordance with paragraph 20.

Other disclosures

102. ***An enterprise should disclose the following if not disclosed elsewhere in information published with the financial statements:***
- (a) ***the domicile and legal form of the enterprise, its country of incorporation and the address of the registered office (or principal place of business, if different from the registered office);***
 - (b) ***a description of the nature of the enterprise's operations and its principal activities;***
 - (c) ***the name of the parent enterprise and the ultimate parent enterprise of the group; and***
 - (d) ***either the number of employees at the end of the period or the average for the period.***

EFFECTIVE DATE

103. ***This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 July 1998. Earlier application is encouraged.***
104. This International Accounting Standard supersedes IAS 1, disclosure of accounting policies, IAS 5, information to be disclosed in financial statements, and IAS 13, presentation of current assets and current liabilities, approved by the Board in reformatted versions in 1994.

**INTERNATIONAL ACCOUNTING STANDARD IAS 2
(REVISED 1993)**

Inventories

This revised International Accounting Standard supersedes IAS 2, valuation and presentation of inventories in the context of the historical cost system, approved by the Board in October 1975. The revised Standard became effective for financial statements covering periods beginning on or after 1 January 1995.

In May 1999, IAS 10 (revised 1999), events after the balance sheet date, amended paragraph 28. The amended text is effective for annual financial statements covering periods beginning on or after 1 January 2000.

In December 2000, IAS 41, agriculture, amended paragraph 1 and inserted paragraph 16A. The amended text is effective for annual financial statements covering periods beginning on or after 1 January 2003.

One SIC interpretation relates to IAS 2:

- SIC-1: Consistency — different cost formulas for inventories.

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

OBJECTIVE

The objective of this Standard is to prescribe the accounting treatment for inventories under the historical cost system. A primary issue in accounting for inventories is the amount of cost to be recognised as an asset and carried forward until the related revenues are recognised. This Standard provides practical guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realisable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

SCOPE

1. ***This Standard should be applied in financial statements prepared in the context of the historical cost system in accounting for inventories other than:***
 - (a) ***work in progress arising under construction contracts, including directly related service contracts (see IAS 11, construction contracts);***
 - (b) ***financial instruments; and***
 - (c) ***producers' inventories of livestock, agricultural and forest products, and mineral ores to the extent that they are measured at net realisable value in accordance with well established practices in certain industries;***
 - (d) ***biological assets related to agricultural activity (see IAS 41 Agriculture).***
2. This Standard supersedes IAS 2, valuation and presentation of inventories in the context of the historical cost system, approved in 1975.
3. The inventories referred to in paragraph 1(c) are measured at net realisable value at certain stages of production. This occurs, for example, when agricultural crops have been harvested or mineral ores have been extracted and sale is assured under a forward contract or a government guarantee, or when a homogenous market exists and there is a negligible risk of failure to sell. These inventories are excluded from the scope of this Standard.

DEFINITIONS

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

Inventories are assets:

- (a) ***held for sale in the ordinary course of business;***
- (b) ***in the process of production for such sale; or***
- (c) ***in the form of materials or supplies to be consumed in the production process or in the rendering of services.***

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

5. Inventories encompass goods purchased and held for resale including, for example, merchandise purchased by a retailer and held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in progress being produced, by the enterprise and include materials and supplies awaiting use in the production process. In the case of a service provider, inventories include the costs of the service, as described in paragraph 16, for which the enterprise has not yet recognised the related revenue (see IAS 18, revenue).

MEASUREMENT OF INVENTORIES

6. ***Inventories should be measured at the lower of cost and net realisable value.***

Cost of inventories

7. ***The cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.***

Costs of purchase

8. The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.
9. The costs of purchase may include foreign exchange differences which arise directly on the recent acquisition of inventories invoiced in a foreign currency in the rare circumstances permitted in the allowed alternative treatment in IAS 21, The effects of changes in foreign exchange rates. These exchange differences are limited to those resulting 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 on the recent acquisition of the inventories.

Costs of conversion

10. The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.
11. The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.
12. A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

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Other costs

13. Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include non-production overheads or the costs of designing products for specific customers in the cost of inventories.
14. Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:
 - (a) abnormal amounts of wasted materials, labour, or other production costs;
 - (b) storage costs, unless those costs are necessary in the production process prior to a further production stage;
 - (c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and
 - (d) selling costs.
15. In limited circumstances, borrowing costs are included in the cost of inventories. These circumstances are identified in the allowed alternative treatment in IAS 23, borrowing costs.

Cost of inventories of a service provider

16. The cost of inventories of a service provider consists primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel, and attributable overheads. Labour and other costs relating to sales and general administrative personnel are not included but are recognised as expenses in the period in which they are incurred.

Cost of agricultural produce harvested from biological assets

- 16A. Under IAS 41, agriculture, inventories comprising agricultural produce that an enterprise has harvested from its biological assets are measured on initial recognition at their fair value less estimated point-of-sale costs at the point of harvest. This is the cost of the inventories at that date for application of this Standard.

Techniques for the measurement of cost

17. Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate cost. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions.
18. The retail method is often used in the retail industry for measuring inventories of large numbers of rapidly changing items, that have similar margins and for which it is impracticable to use other costing methods. The cost of the inventory is determined by reducing the sales value of the inventory by the appropriate percentage gross margin. The percentage used takes into consideration inventory which has been marked down to below its original selling price. An average percentage for each retail department is often used.

Cost formulas

19. ***The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by using specific identification of their individual costs.***

20. Specific identification of cost means that specific costs are attributed to identified items of inventory. This is an appropriate treatment for items that are segregated for a specific project, regardless of whether they have been bought or produced. However, specific identification of costs is inappropriate when there are large numbers of items of inventory which are ordinarily interchangeable. In such circumstances, the method of selecting those items that remain in inventories could be used to obtain predetermined effects on the net profit or loss for the period.

Benchmark treatment

21. ***The cost of inventories, other than those dealt with in paragraph 19, should be assigned by using the first-in, first-out (FIFO) or weighted average cost formulas⁽¹⁾.***
22. The FIFO formula assumes that the items of inventory which were purchased first are sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the enterprise.

Allowed alternative treatment

23. ***The cost of inventories, other than those dealt with in paragraph 19, should be assigned by using the last-in, first-out (LIFO) formula⁽¹⁾.***
24. The LIFO formula assumes that the items of inventory which were purchased or produced last are sold first, and consequently the items remaining in inventory at the end of the period are those first purchased or produced.

Net realisable value

25. The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale have increased. The practice of writing inventories down below cost to net realisable value is consistent with the view that assets should not be carried in excess of amounts expected to be realised from their sale or use.
26. Inventories are usually written down to net realisable value on an item by item basis. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area, and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write inventories down based on a classification of inventory, for example, finished goods, or all the inventories in a particular industry or geographical segment. Service providers generally accumulate costs in respect of each service for which a separate selling price will be charged. Therefore, each such service is treated as a separate item.
27. Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made as to the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period.

⁽¹⁾ See also SIC-1: consistency — different cost formulas for inventories.

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28. Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess is based on general selling prices. Provisions or contingent liabilities may arise from firm sales contracts in excess of inventory quantities held or from firm purchase contracts. Such provisions or contingent liabilities are dealt with under IAS 37, provisions, contingent liabilities and contingent assets.
29. Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when a decline in the price of materials indicates that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.
30. A new assessment is made of net realisable value in each subsequent period. When the circumstances which previously caused inventories to be written down below cost no longer exist, the amount of the write-down is reversed so that the new carrying amount is the lower of the cost and the revised net realisable value. This occurs, for example, when an item of inventory, which is carried at net realisable value because its selling price has declined, is still on hand in a subsequent period and its selling price has increased.

RECOGNITION AS AN EXPENSE

31. ***When inventories are sold, the carrying amount of those inventories should be recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories should be recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, should be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.***
32. The process of recognising as an expense the carrying amount of inventories sold results in the matching of costs and revenues.
33. Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are recognised as an expense during the useful life of that asset.

DISCLOSURE

34. ***The financial statements should disclose:***
 - (a) ***the accounting policies adopted in measuring inventories, including the cost formula used;***
 - (b) ***the total carrying amount of inventories and the carrying amount in classifications appropriate to the enterprise;***
 - (c) ***the carrying amount of inventories carried at net realisable value;***
 - (d) ***the amount of any reversal of any write-down that is recognised as income in the period in accordance with paragraph 31;***
 - (e) ***the circumstances or events that led to the reversal of a write-down of inventories in accordance with paragraph 31; and***
 - (f) ***the carrying amount of inventories pledged as security for liabilities.***

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35. Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are merchandise, production supplies, materials, work in progress and finished goods. The inventories of a service provider may simply be described as work in progress.
36. **When the cost of inventories is determined using the LIFO formula in accordance with the allowed alternative treatment in paragraph 23, the financial statements should disclose the difference between the amount of inventories as shown in the balance sheet and either:**
- (a) **the lower of the amount arrived at in accordance with paragraph 21 and net realisable value; or**
 - (b) **the lower of current cost at the balance sheet date and net realisable value.**
37. **The financial statements should disclose either:**
- (a) **the cost of inventories recognised as an expense during the period; or**
 - (b) **the operating costs, applicable to revenues, recognised as an expense during the period, classified by their nature.**
38. The cost of inventories recognised as an expense during the period consists of those costs previously included in the measurement of the items of inventory sold and unallocated production overheads and abnormal amounts of production costs of inventories. The circumstances of the enterprise may also warrant the inclusion of other costs, such as distribution costs.
39. Some enterprises adopt a different format for the income statement which results in different amounts being disclosed instead of the cost of inventories recognised as an expense during the period. Under this different format, an enterprise discloses the amounts of operating costs, applicable to revenues for the period, classified by their nature. In this case, the enterprise discloses the costs recognised as an expense for raw materials and consumables, labour costs and other operating costs together with the amount of the net change in inventories for the period.
40. A write-down to net realisable value may be of such size, incidence or nature to require disclosure under IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies.

EFFECTIVE DATE

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

**INTERNATIONAL ACCOUNTING STANDARD IAS 7
(REVISED 1992)**

Cash flow statements

This revised International Accounting Standard supersedes IAS 7, Statement of Changes in Financial Position, approved by the Board in October 1977. The revision became effective for financial statements covering periods beginning on or after 1 January 1994.

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

OBJECTIVE

Information about the cash flows of an enterprise is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilise those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents and the timing and certainty of their generation.

The objective of this Standard is to require the provision of information about the historical changes in cash and cash equivalents of an enterprise by means of a cash flow statement which classifies cash flows during the period from operating, investing and financing activities.

SCOPE

1. ***An enterprise should prepare a cash flow statement in accordance with the requirements of this Standard and should present it as an integral part of its financial statements for each period for which financial statements are presented.***
2. This Standard supersedes IAS 7, statement of changes in financial position, approved in July 1977.
3. Users of an enterprise's financial statements are interested in how the enterprise generates and uses cash and cash equivalents. This is the case regardless of the nature of the enterprise's activities and irrespective of whether cash can be viewed as the product of the enterprise, as may be the case with a financial institution. Enterprises need cash for essentially the same reasons however different their principal revenue-producing activities might be. They need cash to conduct their operations, to pay their obligations, and to provide returns to their investors. Accordingly, this Standard requires all enterprises to present a cash flow statement.

BENEFITS OF CASH FLOW INFORMATION

4. A cash flow statement, when used in conjunction with the rest of the financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities. Cash flow information is useful in assessing the ability of the enterprise to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different enterprises. It also enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatments for the same transactions and events.
5. Historical cash flow information is often used as an indicator of the amount, timing and certainty of future cash flows. It is also useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing prices.

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DEFINITIONS

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

Cash comprises cash on hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flows are inflows and outflows of cash and cash equivalents.

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

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Financing activities are activities that result in changes in the size and composition of the equity capital and borrowings of the enterprise.

Cash and cash equivalents

7. Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preferred shares acquired within a short period of their maturity and with a specified redemption date.
8. Bank borrowings are generally considered to be financing activities. However, in some countries, bank overdrafts which are repayable on demand form an integral part of an enterprise's cash management. In these circumstances, bank overdrafts are included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn.
9. Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an enterprise rather than part of its operating, investing and financing activities. Cash management includes the investment of excess cash in cash equivalents.

PRESENTATION OF A CASH FLOW STATEMENT

10. ***The cash flow statement should report cash flows during the period classified by operating, investing and financing activities.***
11. An enterprise presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the enterprise and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.
12. A single transaction may include cash flows that are classified differently. For example, when the cash repayment of a loan includes both interest and capital, the interest element may be classified as an operating activity and the capital element is classified as a financing activity.

Operating activities

13. The amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the enterprise have generated sufficient cash flows to repay loans, maintain the operating capability of the enterprise, pay dividends and make new investments without recourse to external sources of financing. Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows.
14. Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the enterprise. Therefore, they generally result from the transactions and other events that enter into the determination of net profit or loss. Examples of cash flows from operating activities are:
- (a) cash receipts from the sale of goods and the rendering of services;
 - (b) cash receipts from royalties, fees, commissions and other revenue;
 - (c) cash payments to suppliers for goods and services;
 - (d) cash payments to and on behalf of employees;
 - (e) cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits;
 - (f) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and
 - (g) cash receipts and payments from contracts held for dealing or trading purposes.

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

15. An enterprise may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by financial institutions are usually classified as operating activities since they relate to the main revenue-producing activity of that enterprise.

Investing activities

16. The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Examples of cash flows arising from investing activities are:
- (a) cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalised development costs and self-constructed property, plant and equipment;
 - (b) cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
 - (c) cash payments to acquire equity or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);
 - (d) cash receipts from sales of equity or debt instruments of other enterprises and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);
 - (e) cash advances and loans made to other parties (other than advances and loans made by a financial institution);
 - (f) cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);

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- (g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and
- (h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

When a contract is accounted for as a hedge of an identifiable position, the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

Financing activities

17. The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of capital to the enterprise. Examples of cash flows arising from financing activities are:
- (a) cash proceeds from issuing shares or other equity instruments;
 - (b) cash payments to owners to acquire or redeem the enterprise's shares;
 - (c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short or long-term borrowings;
 - (d) cash repayments of amounts borrowed; and
 - (e) cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

REPORTING CASH FLOWS FROM OPERATING ACTIVITIES

18. ***An enterprise should report cash flows from operating activities using either:***
- (a) ***the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or***
 - (b) ***the indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.***
19. Enterprises are encouraged to report cash flows from operating activities using the direct method. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:
- (a) from the accounting records of the enterprise; or
 - (b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial institution) and other items in the income statement for:
 - (i) changes during the period in inventories and operating receivables and payables;
 - (ii) other non-cash items; and
 - (iii) other items for which the cash effects are investing or financing cash flows.

20. Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of:
- (a) changes during the period in inventories and operating receivables and payables;
 - (b) non-cash items such as depreciation, provisions, deferred taxes, unrealised foreign currency gains and losses, undistributed profits of associates, and minority interests; and
 - (c) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the revenues and expenses disclosed in the income statement and the changes during the period in inventories and operating receivables and payables.

REPORTING CASH FLOWS FROM INVESTING AND FINANCING ACTIVITIES

21. ***An enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22 and 24 are reported on a net basis.***

REPORTING CASH FLOWS ON A NET BASIS

22. ***Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:***
- (a) ***cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the enterprise; and***
 - (b) ***cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.***
23. Examples of cash receipts and payments referred to in paragraph 22(a) are:
- (a) the acceptance and repayment of demand deposits of a bank;
 - (b) funds held for customers by an investment enterprise; and
 - (c) rents collected on behalf of, and paid over to, the owners of properties.

Examples of cash receipts and payments referred to in paragraph 22(b) are advances made for, and the repayment of:

- (a) principal amounts relating to credit card customers;
 - (b) the purchase and sale of investments; and
 - (c) other short-term borrowings, for example, those which have a maturity period of three months or less.
24. ***Cash flows arising from each of the following activities of a financial institution may be reported on a net basis:***
- (a) ***cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;***
 - (b) ***the placement of deposits with and withdrawal of deposits from other financial institutions; and***
 - (c) ***cash advances and loans made to customers and the repayment of those advances and loans.***

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FOREIGN CURRENCY CASH FLOWS

25. ***Cash flows arising from transactions in a foreign currency should be recorded in an enterprise's 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 cash flow.***
26. ***The cash flows of a foreign subsidiary should be translated at the exchange rates between the reporting currency and the foreign currency at the dates of the cash flows.***
27. Cash flows denominated in a foreign currency are reported in a manner consistent with IAS 21, accounting for the effects of changes in foreign exchange rates. This permits the use of an exchange rate that approximates the actual rate. For example, a weighted average exchange rate for a period may be used for recording foreign currency transactions or the translation of the cash flows of a foreign subsidiary. However, IAS 21 does not permit use of the exchange rate at the balance sheet date when translating the cash flows of a foreign subsidiary.
28. Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

EXTRAORDINARY ITEMS

29. ***The cash flows associated with extraordinary items should be classified as arising from operating, investing or financing activities as appropriate and separately disclosed.***
30. The cash flows associated with extraordinary items are disclosed separately as arising from operating, investing or financing activities in the cash flow statement, to enable users to understand their nature and effect on the present and future cash flows of the enterprise. These disclosures are in addition to the separate disclosures of the nature and amount of extraordinary items required by IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies.

INTEREST AND DIVIDENDS

31. ***Cash flows from interest and dividends received and paid should each be disclosed separately. Each should be classified in a consistent manner from period to period as either operating, investing or financing activities.***
32. The total amount of interest paid during a period is disclosed in the cash flow statement whether it has been recognised as an expense in the income statement or capitalised in accordance with the allowed alternative treatment in IAS 23, borrowing costs.
33. Interest paid and interest and dividends received are usually classified as operating cash flows for a financial institution. However, there is no consensus on the classification of these cash flows for other enterprises. Interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of net profit or loss. Alternatively, interest paid and interest and dividends received may be classified as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.
34. Dividends paid may be classified as a financing cash flow because they are a cost of obtaining financial resources. Alternatively, dividends paid may be classified as a component of cash flows from operating activities in order to assist users to determine the ability of an enterprise to pay dividends out of operating cash flows.

TAXES ON INCOME

35. ***Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.***
36. Taxes on income arise on transactions that give rise to cash flows that are classified as operating, investing or financing activities in a cash flow statement. While tax expense may be readily identifiable with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of the underlying transaction. Therefore, taxes paid are usually classified as cash flows from operating activities. However, when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities the tax cash flow is classified as an investing or financing activity as appropriate. When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed.

INVESTMENTS IN SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES

37. When accounting for an investment in an associate or a subsidiary accounted for by use of the equity or cost method, an investor restricts its reporting in the cash flow statement to the cash flows between itself and the investee, for example, to dividends and advances.
38. An enterprise which reports its interest in a jointly controlled entity (see IAS 31, financial reporting of interests in joint ventures) using proportionate consolidation, includes in its consolidated cash flow statement its proportionate share of the jointly controlled entity's cash flows. An enterprise which reports such an interest using the equity method includes in its cash flow statement the cash flows in respect of its investments in the jointly controlled entity, and distributions and other payments or receipts between it and the jointly controlled entity.

ACQUISITIONS AND DISPOSALS OF SUBSIDIARIES AND OTHER BUSINESS UNITS

39. ***The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented separately and classified as investing activities.***
40. ***An enterprise should disclose, in aggregate, in respect of both acquisitions and disposals of subsidiaries or other business units during the period each of the following:***
- (a) ***the total purchase or disposal consideration;***
 - (b) ***the portion of the purchase or disposal consideration discharged by means of cash and cash equivalents;***
 - (c) ***the amount of cash and cash equivalents in the subsidiary or business unit acquired or disposed of; and***
 - (d) ***the amount of the assets and liabilities other than cash or cash equivalents in the subsidiary or business unit acquired or disposed of, summarised by each major category.***
41. The separate presentation of the cash flow effects of acquisitions and disposals of subsidiaries and other business units as single line items, together with the separate disclosure of the amounts of assets and liabilities acquired or disposed of, helps to distinguish those cash flows from the cash flows arising from the other operating, investing and financing activities. The cash flow effects of disposals are not deducted from those of acquisitions.
42. The aggregate amount of the cash paid or received as purchase or sale consideration is reported in the cash flow statement net of cash and cash equivalents acquired or disposed of.

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NON-CASH TRANSACTIONS

43. ***Investing and financing transactions that do not require the use of cash or cash equivalents should be excluded from a cash flow statement. Such transactions should be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.***
44. Many investing and financing activities do not have a direct impact on current cash flows although they do affect the capital and asset structure of an enterprise. The exclusion of non-cash transactions from the cash flow statement is consistent with the objective of a cash flow statement as these items do not involve cash flows in the current period. Examples of non-cash transactions are:
- (a) the acquisition of assets either by assuming directly related liabilities or by means of a finance lease;
 - (b) the acquisition of an enterprise by means of an equity issue; and
 - (c) the conversion of debt to equity.

COMPONENTS OF CASH AND CASH EQUIVALENTS

45. ***An enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.***
46. In view of the variety of cash management practices and banking arrangements around the world and in order to comply with IAS 1, presentation of financial statements, an enterprise discloses the policy which it adopts in determining the composition of cash and cash equivalents.
47. The effect of any change in the policy for determining components of cash and cash equivalents, for example, a change in the classification of financial instruments previously considered to be part of an enterprise's investment portfolio, is reported in accordance with IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies.

OTHER DISCLOSURES

48. ***An enterprise should disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by the group.***
49. There are various circumstances in which cash and cash equivalent balances held by an enterprise are not available for use by the group. Examples include cash and cash equivalent balances held by a subsidiary that operates in a country where exchange controls or other legal restrictions apply when the balances are not available for general use by the parent or other subsidiaries.
50. Additional information may be relevant to users in understanding the financial position and liquidity of an enterprise. Disclosure of this information, together with a commentary by management, is encouraged and may include:
- (a) the amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities;
 - (b) the aggregate amounts of the cash flows from each of operating, investing and financing activities related to interests in joint ventures reported using proportionate consolidation;
 - (c) the aggregate amount of cash flows that represent increases in operating capacity separately from those cash flows that are required to maintain operating capacity; and

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- (d) the amount of the cash flows arising from the operating, investing and financing activities of each reported industry and geographical segment (see IAS 14, segment reporting).
51. The separate disclosure of cash flows that represent increases in operating capacity and cash flows that are required to maintain operating capacity is useful in enabling the user to determine whether the enterprise is investing adequately in the maintenance of its operating capacity. An enterprise that does not invest adequately in the maintenance of its operating capacity may be prejudicing future profitability for the sake of current liquidity and distributions to owners.
52. The disclosure of segmental cash flows enables users to obtain a better understanding of the relationship between the cash flows of the business as a whole and those of its component parts and the availability and variability of segmental cash flows.

EFFECTIVE DATE

53. ***This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1994.***

**INTERNATIONAL ACCOUNTING STANDARD IAS 8
(REVISED 1993)**

Net profit or loss for the period, fundamental errors and changes in accounting policies

IAS 35, discontinuing operations, supersedes paragraphs 4 and 19 to 22 of IAS 8. IAS 35 also supersedes the definition of discontinued operations in paragraph 6 of IAS 8. IAS 35 is operative for financial statements covering periods beginning on or after 1 January 1999.

IAS 40, investment property, amended paragraph 44, which also is now set in bold italic type. IAS 40 is operative for annual financial statements covering periods beginning on or after 1 January 2001.

One SIC interpretation relates to IAS 8:

- SIC-8: first-time Application of IASs as the primary basis of accounting.

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

OBJECTIVE

The objective of this Standard is to prescribe the classification, disclosure and accounting treatment of certain items in the income statement so that all enterprises prepare and present an income statement on a consistent basis. This enhances comparability both with the enterprise's financial statements of previous periods and with the financial statements of other enterprises. Accordingly, this Standard requires the classification and disclosure of extraordinary items and the disclosure of certain items within profit or loss from ordinary activities. It also specifies the accounting treatment for changes in accounting estimates, changes in accounting policies and the correction of fundamental errors.

SCOPE

- This Standard should be applied in presenting profit or loss from ordinary activities and extraordinary items in the income statement and in accounting for changes in accounting estimates, fundamental errors and changes in accounting policies.***
- This Standard supersedes IAS 8, unusual and prior period items and changes in accounting policies, approved in 1977.
- This Standard deals with, among other things, the disclosure of certain items of net profit or loss for the period. These disclosures are made in addition to any other disclosures required by other International Accounting Standards, including IAS 1, presentation of financial statements.
- (Deleted)
- The tax effects of extraordinary items, fundamental errors and changes in accounting policies are accounted for and disclosed in accordance with IAS 12, income taxes. Where IAS 12 refers to unusual items, this should be read as extraordinary items as defined in this Standard.

DEFINITIONS

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

Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly.

Ordinary activities are any activities which are undertaken by an enterprise as part of its business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from these activities.

Fundamental errors are errors discovered in the current period that are of such significance that the financial statements of one or more prior periods can no longer be considered to have been reliable at the date of their issue.

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

NET PROFIT OR LOSS FOR THE PERIOD

7. *All items of income and expense recognised in a period should be included in the determination of the net profit or loss for the period unless an International Accounting Standard requires or permits otherwise.*
8. Normally, all items of income and expense recognised in a period are included in the determination of the net profit or loss for the period. This includes extraordinary items and the effects of changes in accounting estimates. However, circumstances may exist when certain items may be excluded from net profit or loss for the current period. This Standard deals with two such circumstances: the correction of fundamental errors and the effect of changes in accounting policies.
9. Other International Accounting Standards deal with items which may meet the framework definitions of income or expense but which are usually excluded from the determination of the net profit or loss. Examples include revaluation surpluses (see IAS 16, property, plant and equipment) and gains and losses arising on the translation of the financial statements of a foreign entity (see IAS 21, the effects of changes in foreign exchange rates).
10. *The net profit or loss for the period comprises the following components, each of which should be disclosed on the face of the income statement:*
 - (a) *profit or loss from ordinary activities; and*
 - (b) *extraordinary items.*

Extraordinary items

11. *The nature and the amount of each extraordinary item should be separately disclosed.*
12. Virtually all items of income and expense included in the determination of net profit or loss for the period arise in the course of the ordinary activities of the enterprise. Therefore, only on rare occasions does an event or transaction give rise to an extraordinary item.
13. Whether an event or transaction is clearly distinct from the ordinary activities of the enterprise is determined by the nature of the event or transaction in relation to the business ordinarily carried on by the enterprise rather than by the frequency with which such events are expected to occur. Therefore, an event or transaction may be extraordinary for one enterprise but not extraordinary for another enterprise because of the differences between their respective ordinary activities. For example, losses sustained as a result of an earthquake may qualify as an extraordinary item for many enterprises. However, claims from policyholders arising from an earthquake do not qualify as an extraordinary item for an insurance enterprise that insures against such risks.
14. Examples of events or transactions that generally give rise to extraordinary items for most enterprises are:
 - (a) the expropriation of assets; or
 - (b) an earthquake or other natural disaster.
15. The disclosure of the nature and amount of each extraordinary item may be made on the face of the income statement, or when this disclosure is made in the notes to the financial statements, the total amount of all extraordinary items is disclosed on the face of the income statement.

IAS 8*Profit or loss from ordinary activities*

16. ***When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.***
17. Although the items of income and expense described in paragraph 16 are not extraordinary items, the nature and amount of such items may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. Disclosure of such information is usually made in the notes to the financial statements.
18. Circumstances which may give rise to the separate disclosure of items of income and expense in accordance with paragraph 16 include:
- (a) the write-down of inventories to net realisable value or property, plant and equipment to recoverable amount, as well as the reversal of such write-downs;
 - (b) a restructuring of the activities of an enterprise and the reversal of any provisions for the costs of restructuring;
 - (c) disposals of items of property, plant and equipment;
 - (d) disposals of long-term investments;
 - (e) discontinued operations;
 - (f) litigation settlements; and
 - (g) other reversals of provisions.
- 19-22. (Deleted — see IAS 35, discontinuing operations.)

Changes in accounting estimates

23. As a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgements based on the latest information available. Estimates may be required, for example, of bad debts, inventory obsolescence or the useful lives or expected pattern of consumption of economic benefits of depreciable assets. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.
24. An estimate may have to be revised if changes occur regarding the circumstances on which the estimate was based or as a result of new information, more experience or subsequent developments. By its nature, the revision of the estimate does not bring the adjustment within the definitions of an extraordinary item or a fundamental error.
25. Sometimes it is difficult to distinguish between a change in accounting policy and a change in an accounting estimate. In such cases, the change is treated as a change in an accounting estimate, with appropriate disclosure.
26. ***The effect of a change in an accounting estimate should be included in the determination of net profit or loss in:***
- (a) ***the period of the change, if the change affects the period only; or***
 - (b) ***the period of the change and future periods, if the change affects both.***
27. A change in an accounting estimate may affect the current period only or both the current period and future periods. For example, a change in the estimate of the amount of bad debts affects only the current period and therefore is recognised immediately. However, a change in the estimated useful life or the expected pattern of consumption of economic benefits of a depreciable asset affects the depreciation expense in the current period and in each period during the remaining useful life of the asset. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods is recognised in future periods.

28. ***The effect of a change in an accounting estimate should be included in the same income statement classification as was used previously for the estimate.***
29. To ensure the comparability of financial statements of different periods, the effect of a change in an accounting estimate for estimates which were previously included in the profit or loss from ordinary activities is included in that component of net profit or loss. The effect of a change in an accounting estimate for an estimate which was previously included as an extraordinary item is reported as an extraordinary item.
30. ***The nature and amount of a change in an accounting estimate that has a material effect in the current period or which is expected to have a material effect in subsequent periods should be disclosed. If it is impracticable to quantify the amount, this fact should be disclosed.***

FUNDAMENTAL ERRORS

31. Errors in the preparation of the financial statements of one or more prior periods may be discovered in the current period. Errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, fraud or oversights. The correction of these errors is normally included in the determination of net profit or loss for the current period.
32. On rare occasions, an error has such a significant effect on the financial statements of one or more prior periods that those financial statements can no longer be considered to have been reliable at the date of their issue. These errors are referred to as fundamental errors. An example of a fundamental error is the inclusion in the financial statements of a previous period of material amounts of work in progress and receivables in respect of fraudulent contracts which cannot be enforced. The correction of fundamental errors that relate to prior periods requires the restatement of the comparative information or the presentation of additional pro forma information.
33. The correction of fundamental errors can be distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need revision as additional information becomes known. For example, the gain or loss recognised on the outcome of a contingency which previously could not be estimated reliably does not constitute the correction of a fundamental error.

Benchmark treatment

34. ***The amount of the correction of a fundamental error that relates to prior periods should be reported by adjusting the opening balance of retained earnings. Comparative information should be restated, unless it is impracticable to do so.***
35. The financial statements, including the comparative information for prior periods, are presented as if the fundamental error had been corrected in the period in which it was made. Therefore, the amount of the correction that relates to each period presented is included within the net profit or loss for that period. The amount of the correction relating to periods prior to those included in the comparative information in the financial statements is adjusted against the opening balance of retained earnings in the earliest period presented. Any other information reported with respect to prior periods, such as historical summaries of financial data, is also restated.
36. The restatement of comparative information does not necessarily give rise to the amendment of financial statements which have been approved by shareholders or registered or filed with regulatory authorities. However, national laws may require the amendment of such financial statements.
37. ***An enterprise should disclose the following:***
- (a) ***the nature of the fundamental error;***
 - (b) ***the amount of the correction for the current period and for each prior period presented;***
 - (c) ***the amount of the correction relating to periods prior to those included in the comparative information; and***
 - (d) ***the fact that comparative information has been restated or that it is impracticable to do so.***

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Allowed alternative treatment

38. ***The amount of the correction of a fundamental error should be included in the determination of net profit or loss for the current period. Comparative information should be presented as reported in the financial statements of the prior period. Additional pro forma information, prepared in accordance with paragraph 34, should be presented unless it is impracticable to do so.***
39. The correction of the fundamental error is included in the determination of the net profit or loss for the current period. However, additional information is presented, often as separate columns, to show the net profit or loss of the current period and any prior periods presented as if the fundamental error had been corrected in the period when it was made. It may be necessary to apply this accounting treatment in countries where the financial statements are required to include comparative information which agrees with the financial statements presented in prior periods.
40. ***An enterprise should disclose the following:***
- (a) ***the nature of the fundamental error;***
 - (b) ***the amount of the correction recognised in net profit or loss for the current period; and***
 - (c) ***the amount of the correction included in each period for which pro forma information is presented and the amount of the correction relating to periods prior to those included in the pro forma information. If it is impracticable to present pro forma information, this fact should be disclosed.***

CHANGES IN ACCOUNTING POLICIES

41. Users need to be able to compare the financial statements of an enterprise over a period of time to identify trends in its financial position, performance and cash flows. Therefore, the same accounting policies are normally adopted in each period.
42. ***A change in accounting policy should be made only if required by statute, or by an accounting standard setting body, or if the change will result in a more appropriate presentation of events or transactions in the financial statements of the enterprise.***
43. A more appropriate presentation of events or transactions in the financial statements occurs when the new accounting policy results in more relevant or reliable information about the financial position, performance or cash flows of the enterprise.
44. ***The following are not changes in accounting policies:***
- (a) ***the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions; and***
 - (b) ***the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial.***

The initial adoption of a policy to carry assets at revalued amounts under the allowed alternative treatment in IAS 16, property, plant and equipment, or IAS 38, intangible assets, is a change in accounting policy but it is dealt with as a revaluation in accordance with IAS 16 or IAS 38, rather than in accordance with this Standard. Therefore, paragraphs 49 to 57 of this Standard are not applicable to such changes in accounting policy.

45. A change in accounting policy is applied retrospectively or prospectively in accordance with the requirements of this Standard. Retrospective application results in the new accounting policy being applied to events and transactions as if the new accounting policy had always been in use. Therefore, the accounting policy is applied to events and transactions from the date of origin of such items. Prospective application means that the new accounting policy is applied to the events and transactions occurring after the date of the change. No adjustments relating to prior periods are made either to the opening balance of retained earnings or in reporting the net profit or loss for the current period because existing balances are not recalculated. However, the new accounting policy is applied to existing balances as from the date of the change. For example, an enterprise may decide to change its accounting policy for borrowing costs and capitalise those costs in conformity with the allowed alternative treatment in IAS 23, Borrowing Costs. Under prospective application, the new policy only applies to borrowing costs that are incurred after the date of the change in accounting policy.

Adoption of an International Accounting Standard

46. ***A change in accounting policy which is made on the adoption of an International Accounting Standard should be accounted for in accordance with the specific transitional provisions, if any, in that International Accounting Standard. In the absence of any transitional provisions, the change in accounting policy should be applied in accordance with the benchmark treatment in paragraphs 49, 52 and 53 or the allowed alternative treatment in paragraphs 54, 56 and 57.***
47. The transitional provisions in an International Accounting Standard may require either a retrospective or a prospective application of a change in accounting policy.
48. When an enterprise has not adopted a new International Accounting Standard which has been published by the International Accounting Standards Committee but which has not yet come into effect, the enterprise is encouraged to disclose the nature of the future change in accounting policy and an estimate of the effect of the change on its net profit or loss and financial position.

Other changes in accounting policies — benchmark treatment

49. ***A change in accounting policy should be applied retrospectively unless the amount of any resulting adjustment that relates to prior periods is not reasonably determinable. Any resulting adjustment should be reported as an adjustment to the opening balance of retained earnings. Comparative information should be restated unless it is impracticable to do so ⁽¹⁾.***
50. The financial statements, including the comparative information for prior periods, are presented as if the new accounting policy had always been in use. Therefore, comparative information is restated in order to reflect the new accounting policy. The amount of the adjustment relating to periods prior to those included in the financial statements is adjusted against the opening balance of retained earnings of the earliest period presented. Any other information with respect to prior periods, such as historical summaries of financial data, is also restated.
51. The restatement of comparative information does not necessarily give rise to the amendment of financial statements which have been approved by shareholders or registered or filed with regulatory authorities. However, national laws may require the amendment of such financial statements.
52. ***The change in accounting policy should be applied prospectively when the amount of the adjustment to the opening balance of retained earnings required by paragraph 49 cannot be reasonably determined.***
53. ***When a change in accounting policy has a material effect on the current period or any prior period presented, or may have a material effect in subsequent periods, an enterprise should disclose the following:***
- (a) ***the reasons for the change;***
 - (b) ***the amount of the adjustment for the current period and for each period presented;***
 - (c) ***the amount of the adjustment relating to periods prior to those included in the comparative information; and***
 - (d) ***the fact that comparative information has been restated or that it is impracticable to do so.***

⁽²⁾ SIC-8: first-time application of IASs as the primary basis of accounting. This states that it is not appropriate to recognise the cumulative effect of changes resulting from the transition from national GAAP to IAS in the income statement (i.e., the allowed alternative treatment set out in IAS 8.54 is not applicable to the first-time application of IAS as the primary accounting basis).

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Other changes in accounting policies — allowed alternative treatment

54. ***A change in accounting policy should be applied retrospectively unless the amount of any resulting adjustment that relates to prior periods is not reasonably determinable. Any resulting adjustment should be included in the determination of the net profit or loss for the current period. Comparative information should be presented as reported in the financial statements of the prior period. Additional pro forma comparative information, prepared in accordance with paragraph 49, should be presented unless it is impracticable to do so ⁽²⁾.***
55. Adjustments resulting from a change in accounting policy are included in the determination of the net profit or loss for the period. However, additional comparative information is presented, often as separate columns, in order to show the net profit or loss and the financial position of the current period and any prior periods presented as if the new accounting policy had always been applied. It may be necessary to apply this accounting treatment in countries where the financial statements are required to include comparative information which agrees with the financial statements presented in prior periods.
56. ***The change in accounting policy should be applied prospectively when the amount to be included in net profit or loss for the current period required by paragraph 54 cannot be reasonably determined.***
57. ***When a change in accounting policy has a material effect on the current period or any prior period presented, or may have a material effect in subsequent periods, an enterprise should disclose the following:***
- (a) *the reasons for the change;*
 - (b) *the amount of the adjustment recognised in net profit or loss in the current period; and*
 - (c) *the amount of the adjustment included in each period for which pro forma information is presented and the amount of the adjustment relating to periods prior to those included in the financial statements. If it is impracticable to present pro forma information, this fact should be disclosed.*

EFFECTIVE DATE

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

**INTERNATIONAL ACCOUNTING STANDARD IAS 10
(REVISED 1999)****Events after the balance sheet date**

This International Accounting Standard was approved by the IASC Board in March 1999 and became effective for annual financial statements covering periods beginning on or after 1 January 2000.

INTRODUCTION

IAS 10, events after the balance sheet date, replaces those parts of IAS 10, contingencies and events occurring after the balance sheet date, that have not already been superseded by IAS 37, provisions, contingent liabilities and contingent assets. The new Standard makes the following limited changes:

- (a) new disclosures about the date of the authorisation of the financial statements for issue;
- (b) deletion of the option to recognise a liability for dividends that are stated to be in respect of the period covered by the financial statements and are proposed or declared after the balance sheet date but before the financial statements are authorised for issue. An enterprise may give the required disclosure of such dividends either on the face of the balance sheet as a separate component of equity or in the notes to the financial statements;

⁽²⁾ SIC-8: first-time application of IASs as the primary basis of accounting. This states that it is not appropriate to recognise the cumulative effect of changes resulting from the transition from national GAAP to IAS in the income statement (i.e., the allowed alternative treatment set out in IAS 8.54 is not applicable to the first-time application of IAS as the primary accounting basis).

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- (c) confirmation that an enterprise should update disclosures that relate to conditions that existed at the balance sheet date in the light of any new information that it receives after the balance sheet date about those conditions;
- (d) deletion of the requirement to adjust the financial statements where an event after the balance sheet date indicates that the going concern assumption is not appropriate for part of the enterprise. Under IAS 1, presentation of financial statements, the going concern assumption applies to an enterprise as a whole;
- (e) certain refinements to the examples of adjusting and non-adjusting events; and
- (f) various drafting improvements.

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

OBJECTIVE

The objective of this Standard is to prescribe:

- (a) when an enterprise should adjust its financial statements for events after the balance sheet date; and
- (b) the disclosures that an enterprise should give about the date when the financial statements were authorised for issue and about events after the balance sheet date.

The Standard also requires that an enterprise should not prepare its financial statements on a going concern basis if events after the balance sheet date indicate that the going concern assumption is not appropriate.

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SCOPE

1. ***This Standard should be applied in the accounting for, and disclosure of, events after the balance sheet date.***

DEFINITIONS

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

Events after the balance sheet date are those events, both favourable and unfavourable, that occur between the balance sheet date and the date when the financial statements are authorised for issue. Two types of events can be identified:

- (a) ***those that provide evidence of conditions that existed at the balance sheet date (adjusting events after the balance sheet date); and***
 - (b) ***those that are indicative of conditions that arose after the balance sheet date (non-adjusting events after the balance sheet date).***
3. The process involved in authorising the financial statements for issue will vary depending upon the management structure, statutory requirements and procedures followed in preparing and finalising the financial statements.
 4. In some cases, an enterprise is required to submit its financial statements to its shareholders for approval after the financial statements have already been issued. In such cases, the financial statements are authorised for issue on the date of original issuance, not on the date when shareholders approve the financial statements.

Example

The management of an enterprise completes draft financial statements for the year to 31 December 20X1 on 28 February 20X2. On 18 March 20X2, the board of directors reviews the financial statements and authorises them for issue. The enterprise announces its profit and selected other financial information on 19 March 20X2. The financial statements are made available to shareholders and others on 1 April 20X2. The annual meeting of shareholders approves the financial statements on 15 May 20X2 and the approved financial statements are then filed with a regulatory body on 17 May 20X2.

The financial statements are authorised for issue on 18 March 20X2 (date of Board authorisation for issue).

5. In some cases, the management of an enterprise is required to issue its financial statements to a supervisory board (made up solely of non-executives) for approval. In such cases, the financial statements are authorised for issue when the management authorises them for issue to the supervisory board.

Example

On 18 March 20X2, the management of an enterprise authorises financial statements for issue to its supervisory board. The supervisory board is made up solely of non-executives and may include representatives of employees and other outside interests. The supervisory board approves the financial statements on 26 March 20X2. The financial statements are made available to shareholders and others on 1 April 20X2. The annual meeting of shareholders receives the financial statements on 15 May 20X2 and the financial statements are then filed with a regulatory body on 17 May 20X2.

The financial statements are authorised for issue on 18 March 20X2 (date of management authorisation for issue to the supervisory board).

6. Events after the balance sheet date include all events up to the date when the financial statements are authorised for issue, even if those events occur after the publication of a profit announcement or of other selected financial information.

RECOGNITION AND MEASUREMENT

Adjusting events after the balance sheet date

7. ***An enterprise should adjust the amounts recognised in its financial statements to reflect adjusting events after the balance sheet date.***
8. The following are examples of adjusting events after the balance sheet date that require an enterprise to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:
 - (a) the resolution after the balance sheet date of a court case which, because it confirms that an enterprise already had a present obligation at the balance sheet date, requires the enterprise to adjust a provision already recognised, or to recognise a provision instead of merely disclosing a contingent liability;
 - (b) the receipt of information after the balance sheet date indicating that an asset was impaired at the balance sheet date, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted. For example:
 - (i) the bankruptcy of a customer which occurs after the balance sheet date usually confirms that a loss already existed at the balance sheet date on a trade receivable account and that the enterprise needs to adjust the carrying amount of the trade receivable account; and
 - (ii) the sale of inventories after the balance sheet date may give evidence about their net realisable value at the balance sheet date;
 - (c) the determination after the balance sheet date of the cost of assets purchased, or the proceeds from assets sold, before the balance sheet date;
 - (d) the determination after the balance sheet date of the amount of profit sharing or bonus payments, if the enterprise had a present legal or constructive obligation at the balance sheet date to make such payments as a result of events before that date (see IAS 19, employee benefits); and
 - (e) the discovery of fraud or errors that show that the financial statements were incorrect.

Non-adjusting events after the balance sheet date

9. ***An enterprise should not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the balance sheet date.***
10. An example of a non-adjusting event after the balance sheet date is a decline in market value of investments between the balance sheet date and the date when the financial statements are authorised for issue. The fall in market value does not normally relate to the condition of the investments at the balance sheet date, but reflects circumstances that have arisen in the following period. Therefore, an enterprise does not adjust the amounts recognised in its financial statements for the investments. Similarly, the enterprise does not update the amounts disclosed for the investments as at the balance sheet date, although it may need to give additional disclosure under paragraph 20.

Dividends

11. ***If dividends to holders of equity instruments (as defined in IAS 32, financial instruments: disclosure and presentation) are proposed or declared after the balance sheet date, an enterprise should not recognise those dividends as a liability at the balance sheet date.***

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12. IAS 1, presentation of financial statements, requires an enterprise to disclose the amount of dividends that were proposed or declared after the balance sheet date but before the financial statements were authorised for issue. IAS 1 permits an enterprise to make this disclosure either:
- (a) on the face of the balance sheet as a separate component of equity; or
 - (b) in the notes to the financial statements.

GOING CONCERN

13. ***An enterprise should not prepare its financial statements on a going concern basis if management determines after the balance sheet date either that it intends to liquidate the enterprise or to cease trading, or that it has no realistic alternative but to do so.***
14. Deterioration in operating results and financial position after the balance sheet date may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern assumption is no longer appropriate, the effect is so pervasive that this Standard requires a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognised within the original basis of accounting.
15. IAS 1, presentation of financial statements, requires certain disclosures if:
- (a) the financial statements are not prepared on a going concern basis; or
 - (b) management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the enterprise's ability to continue as a going concern. The events or conditions requiring disclosure may arise after the balance sheet date.

DISCLOSURE

Date of authorisation for issue

16. ***An enterprise should disclose the date when the financial statements were authorised for issue and who gave that authorisation. If the enterprise's owners or others have the power to amend the financial statements after issuance, the enterprise should disclose that fact.***
17. It is important for users to know when the financial statements were authorised for issue, as the financial statements do not reflect events after this date.

Updating disclosure about conditions at the balance sheet date

18. ***If an enterprise receives information after the balance sheet date about conditions that existed at the balance sheet date, the enterprise should update disclosures that relate to these conditions, in the light of the new information.***
19. In some cases, an enterprise needs to update the disclosures in its financial statements to reflect information received after the balance sheet date, even when the information does not affect the amounts that the enterprise recognises in its financial statements. One example of the need to update disclosures is when evidence becomes available after the balance sheet date about a contingent liability that existed at the balance sheet date. In addition to considering whether it should now recognise a provision under IAS 37, provisions, contingent liabilities and contingent assets, an enterprise updates its disclosures about the contingent liability in the light of that evidence.

Non-adjusting events after the balance sheet date

20. ***Where non-adjusting events after the balance sheet date are of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions, an enterprise should disclose the following information for each significant category of non-adjusting event after the balance sheet date:***
- (a) ***the nature of the event; and***
 - (b) ***an estimate of its financial effect, or a statement that such an estimate cannot be made.***
21. The following are examples of non-adjusting events after the balance sheet date that may be of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions:
- (a) a major business combination after the balance sheet date (IAS 22, business combinations, requires specific disclosures in such cases) or disposing of a major subsidiary;
 - (b) announcing a plan to discontinue an operation, disposing of assets or settling liabilities attributable to a discontinuing operation or entering into binding agreements to sell such assets or settle such liabilities (see IAS 35, discontinuing operations);
 - (c) major purchases and disposals of assets, or expropriation of major assets by government;
 - (d) the destruction of a major production plant by a fire after the balance sheet date;
 - (e) announcing, or commencing the implementation of, a major restructuring (see IAS 37, provisions, contingent liabilities and contingent assets);
 - (f) major ordinary share transactions and potential ordinary share transactions after the balance sheet date (IAS 33, earnings per share, encourages an enterprise to disclose a description of such transactions, other than capitalisation issues and share splits);
 - (g) abnormally large changes after the balance sheet date in asset prices or foreign exchange rates;
 - (h) changes in tax rates or tax laws enacted or announced after the balance sheet date that have a significant effect on current and deferred tax assets and liabilities (see IAS 12, income taxes);
 - (i) entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees; and
 - (j) commencing major litigation arising solely out of events that occurred after the balance sheet date.

EFFECTIVE DATE

22. ***This International Accounting Standard becomes operative for annual financial statements covering periods beginning on or after 1 January 2000.***
23. In 1998, IAS 37, provisions, contingent liabilities and contingent assets, superseded the parts of IAS 10, contingencies and events occurring after the balance sheet date, that dealt with contingencies. This Standard supersedes the rest of that Standard.

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INTERNATIONAL ACCOUNTING STANDARD IAS 11
(REVISED 1993)

Construction Contracts

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

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

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

OBJECTIVE

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

SCOPE

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

DEFINITIONS

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

A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

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

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

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

COMBINING AND SEGMENTING CONSTRUCTION CONTRACTS

7. The requirements of this Standard are usually applied separately to each construction contract. However, in certain circumstances, it is necessary to apply the Standard to the separately identifiable components of a single contract or to a group of contracts together in order to reflect the substance of a contract or a group of contracts.
8. ***When a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:***
- (a) *separate proposals have been submitted for each asset;*
 - (b) *each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and*
 - (c) *the costs and revenues of each asset can be identified.*
9. ***A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when:***
- (a) *the group of contracts is negotiated as a single package;*
 - (b) *the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and*

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

CONTRACT REVENUE

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

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

CONTRACT COSTS

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

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

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

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

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

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

RECOGNITION OF CONTRACT REVENUE AND EXPENSES

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

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

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

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

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

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

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

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

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

RECOGNITION OF EXPECTED LOSSES

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

CHANGES IN ESTIMATES

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

DISCLOSURE

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

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

EFFECTIVE DATE

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

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

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

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

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

IAS 12

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

The following SIC interpretations relate to IAS 12:

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

INTRODUCTION

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

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

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

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

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

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

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

IAS 12

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

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

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

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

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

IAS 12

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

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

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

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

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

- (b) in respect of discontinued operations, the tax expense relating to:
 - (i) the gain or loss on discontinuance; and
 - (ii) the profit or loss from the ordinary activities of the discontinued operation; and
- (c) the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:
 - (i) the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and
 - (ii) the enterprise has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates.

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

OBJECTIVE

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

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

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

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

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

SCOPE

1. ***This Standard should be applied in accounting for income taxes.***
2. For the purposes of this Standard, income taxes include all domestic and foreign taxes which are based on taxable profits. Income taxes also include taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint venture on distributions to the reporting enterprise.
3. (Deleted)
4. This Standard does not deal with the methods of accounting for government grants (see IAS 20, accounting for government grants and disclosure of government assistance) or investment tax credits. However, this Standard does deal with the accounting for temporary differences that may arise from such grants or investment tax credits.

DEFINITIONS

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

Accounting profit is net profit or loss for a period before deducting tax expense.

Taxable profit (tax loss) is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).

Tax expense (tax income) is the aggregate amount included in the determination of net profit or loss for the period in respect of current tax and deferred tax.

Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of:

- (a) ***deductible temporary differences;***
- (b) ***the carryforward of unused tax losses; and***
- (c) ***the carryforward of unused tax credits.***

Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:

- (a) ***taxable temporary differences, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or***
- (b) ***deductible temporary differences, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.***

The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.

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

IAS 12*Tax base*

7. The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an enterprise when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

Exa m p l e s

1. A machine cost 100. For tax purposes, depreciation of 30 has already been deducted in the current and prior periods and the remaining cost will be deductible in future periods, either as depreciation or through a deduction on disposal. Revenue generated by using the machine is taxable, any gain on disposal of the machine will be taxable and any loss on disposal will be deductible for tax purposes. The tax base of the machine is 70.
2. Interest receivable has a carrying amount of 100. The related interest revenue will be taxed on a cash basis. The tax base of the interest receivable is nil.
3. Trade receivables have a carrying amount of 100. The related revenue has already been included in taxable profit (tax loss). The tax base of the trade receivables is 100.
4. Dividends receivable from a subsidiary have a carrying amount of 100. The dividends are not taxable. In substance, the entire carrying amount of the asset is deductible against the economic benefits. Consequently, the tax base of the dividends receivable is 100 ⁽¹⁾.
5. A loan receivable has a carrying amount of 100. The repayment of the loan will have no tax consequences. The tax base of the loan is 100.
8. The tax base of a liability is its carrying amount, less any amount that will be deductible for tax purposes in respect of that liability in future periods. In the case of revenue which is received in advance, the tax base of the resulting liability is its carrying amount, less any amount of the revenue that will not be taxable in future periods.

Exa m p l e s

1. Current liabilities include accrued expenses with a carrying amount of 100. The related expense will be deducted for tax purposes on a cash basis. The tax base of the accrued expenses is nil.
2. Current liabilities include interest revenue received in advance, with a carrying amount of 100. The related interest revenue was taxed on a cash basis. The tax base of the interest received in advance is nil.
3. Current liabilities include accrued expenses with a carrying amount of 100. The related expense has already been deducted for tax purposes. The tax base of the accrued expenses is 100.
4. Current liabilities include accrued fines and penalties with a carrying amount of 100. Fines and penalties are not deductible for tax purposes. The tax base of the accrued fines and penalties is 100 ⁽²⁾.
5. A loan payable has a carrying amount of 100. The repayment of the loan will have no tax consequences. The tax base of the loan is 100.

⁽¹⁾ Under this analysis, there is no taxable temporary difference. An alternative analysis is that the accrued dividends receivable have a tax base of nil and that a tax rate of nil is applied to the resulting taxable temporary difference of 100. Under both analyses, there is no deferred tax liability.

⁽²⁾ Under this analysis, there is no deductible temporary difference. An alternative analysis is that the accrued fines and penalties payable have a tax base of nil and that a tax rate of nil is applied to the resulting deductible temporary difference of 100. Under both analyses, there is no deferred tax asset.

9. Some items have a tax base but are not recognised as assets and liabilities in the balance sheet. For example, research costs are recognised as an expense in determining accounting profit in the period in which they are incurred but may not be permitted as a deduction in determining taxable profit (tax loss) until a later period. The difference between the tax base of the research costs, being the amount the taxation authorities will permit as a deduction in future periods, and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset.
10. Where the tax base of an asset or liability is not immediately apparent, it is helpful to consider the fundamental principle upon which this Standard is based: that an enterprise should, with certain limited exceptions, recognise a deferred tax liability (asset) whenever recovery or settlement of the carrying amount of an asset or liability would make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences. Example C following Paragraph 52 illustrates circumstances when it may be helpful to consider this fundamental principle, for example, when the tax base of an asset or liability depends on the expected manner of recovery or settlement.
11. In consolidated financial statements, temporary differences are determined by comparing the carrying amounts of assets and liabilities in the consolidated financial statements with the appropriate tax base. The tax base is determined by reference to a consolidated tax return in those jurisdictions in which such a return is filed. In other jurisdictions, the tax base is determined by reference to the tax returns of each enterprise in the group.

RECOGNITION OF CURRENT TAX LIABILITIES AND CURRENT TAX ASSETS

12. ***Current tax for current and prior periods should, to the extent unpaid, be recognised as a liability. If the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess should be recognised as an asset.***
13. ***The benefit relating to a tax loss that can be carried back to recover current tax of a previous period should be recognised as an asset.***
14. When a tax loss is used to recover current tax of a previous period, an enterprise recognises the benefit as an asset in the period in which the tax loss occurs because it is probable that the benefit will flow to the enterprise and the benefit can be reliably measured.

RECOGNITION OF DEFERRED TAX LIABILITIES AND DEFERRED TAX ASSETS

Taxable temporary differences

15. ***A deferred tax liability should be recognised for all taxable temporary differences, unless the deferred tax liability arises from:***
 - (a) *goodwill for which amortisation is not deductible for tax purposes; or*
 - (b) *the initial recognition of an asset or liability in a transaction which:*
 - (i) *is not a business combination; and*
 - (ii) *at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).*

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax liability should be recognised in accordance with paragraph 39.

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16. It is inherent in the recognition of an asset that its carrying amount will be recovered in the form of economic benefits that flow to the enterprise in future periods. When the carrying amount of the asset exceeds its tax base, the amount of taxable economic benefits will exceed the amount that will be allowed as a deduction for tax purposes. This difference is a taxable temporary difference and the obligation to pay the resulting income taxes in future periods is a deferred tax liability. As the enterprise recovers the carrying amount of the asset, the taxable temporary difference will reverse and the enterprise will have taxable profit. This makes it probable that economic benefits will flow from the enterprise in the form of tax payments. Therefore, this Standard requires the recognition of all deferred tax liabilities, except in certain circumstances described in paragraphs 15 and 39.

Example

An asset which cost 150 has a carrying amount of 100. Cumulative depreciation for tax purposes is 90 and the tax rate is 25 %.

The tax base of the asset is 60 (cost of 150 less cumulative tax depreciation of 90). To recover the carrying amount of 100, the enterprise must earn taxable income of 100, but will only be able to deduct tax depreciation of 60. Consequently, the enterprise will pay income taxes of 10 (40 at 25 %) when it recovers the carrying amount of the asset. The difference between the carrying amount of 100 and the tax base of 60 is a taxable temporary difference of 40. Therefore, the enterprise recognises a deferred tax liability of 10 (40 at 25 %) representing the income taxes that it will pay when it recovers the carrying amount of the asset.

17. Some temporary differences arise when income or expense is included in accounting profit in one period but is included in taxable profit in a different period. Such temporary differences are often described as timing differences. The following are examples of temporary differences of this kind which are taxable temporary differences and which therefore result in deferred tax liabilities:
- (a) interest revenue is included in accounting profit on a time proportion basis but may, in some jurisdictions, be included in taxable profit when cash is collected. The tax base of any receivable recognised in the balance sheet with respect to such revenues is nil because the revenues do not affect taxable profit until cash is collected;
 - (b) depreciation used in determining taxable profit (tax loss) may differ from that used in determining accounting profit. The temporary difference is the difference between the carrying amount of the asset and its tax base which is the original cost of the asset less all deductions in respect of that asset permitted by the taxation authorities in determining taxable profit of the current and prior periods. A taxable temporary difference arises, and results in a deferred tax liability, when tax depreciation is accelerated (if tax depreciation is less rapid than accounting depreciation, a deductible temporary difference arises, and results in a deferred tax asset); and
 - (c) development costs may be capitalised and amortised over future periods in determining accounting profit but deducted in determining taxable profit in the period in which they are incurred. Such development costs have a tax base of nil as they have already been deducted from taxable profit. The temporary difference is the difference between the carrying amount of the development costs and their tax base of nil.
18. Temporary differences also arise when:
- (a) the cost of a business combination that is an acquisition is allocated to the identifiable assets and liabilities acquired by reference to their fair values but no equivalent adjustment is made for tax purposes (see paragraph 19);
 - (b) assets are revalued and no equivalent adjustment is made for tax purposes (see paragraph 20);

- (c) goodwill or negative goodwill arises on consolidation (see paragraphs 21 and 32);
- (d) the tax base of an asset or liability on initial recognition differs from its initial carrying amount, for example when an enterprise benefits from non-taxable government grants related to assets (see paragraphs 22 and 33); or
- (e) the carrying amount of investments in subsidiaries, branches and associates or interests in joint ventures becomes different from the tax base of the investment or interest (see paragraphs 38 to 45).

Business combinations

19. In a business combination that is an acquisition, the cost of the acquisition is allocated to the identifiable assets and liabilities acquired by reference to their fair values at the date of the exchange transaction. Temporary differences arise when the tax bases of the identifiable assets and liabilities acquired are not affected by the business combination or are affected differently. For example, when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability. The resulting deferred tax liability affects goodwill (see paragraph 66).

Assets carried at fair value

20. International Accounting Standards permit certain assets to be carried at fair value or to be revalued (see, for example, IAS 16, property, plant and equipment, IAS 38, intangible assets, IAS 39, financial instruments: recognition and measurement, and IAS 40, investment property). In some jurisdictions, the revaluation or other restatement of an asset to fair value affects taxable profit (tax loss) for the current period. As a result, the tax base of the asset is adjusted and no temporary difference arises. In other jurisdictions, the revaluation or restatement of an asset does not affect taxable profit in the period of the revaluation or restatement and, consequently, the tax base of the asset is not adjusted. Nevertheless, the future recovery of the carrying amount will result in a taxable flow of economic benefits to the enterprise and the amount that will be deductible for tax purposes will differ from the amount of those economic benefits. The difference between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset. This is true even if:
- (a) the enterprise does not intend to dispose of the asset. In such cases, the revalued carrying amount of the asset will be recovered through use and this will generate taxable income which exceeds the depreciation that will be allowable for tax purposes in future periods; or
 - (b) tax on capital gains is deferred if the proceeds of the disposal of the asset are invested in similar assets. In such cases, the tax will ultimately become payable on sale or use of the similar assets.

Goodwill

21. Goodwill is the excess of the cost of an acquisition over the acquirer's interest in the fair value of the identifiable assets and liabilities acquired. Many taxation authorities do not allow the amortisation of goodwill as a deductible expense in determining taxable profit. Moreover, in such jurisdictions, the cost of goodwill is often not deductible when a subsidiary disposes of its underlying business. In such jurisdictions, goodwill has a tax base of nil. Any difference between the carrying amount of goodwill and its tax base of nil is a taxable temporary difference. However, this Standard does not permit the recognition of the resulting deferred tax liability because goodwill is a residual and the recognition of the deferred tax liability would increase the carrying amount of goodwill.

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Initial recognition of an asset or liability

22. A temporary difference may arise on initial recognition of an asset or liability, for example if part or all of the cost of an asset will not be deductible for tax purposes. The method of accounting for such a temporary difference depends on the nature of the transaction which led to the initial recognition of the asset:
- (a) in a business combination, an enterprise recognises any deferred tax liability or asset and this affects the amount of goodwill or negative goodwill (see paragraph 19);
 - (b) if the transaction affects either accounting profit or taxable profit, an enterprise recognises any deferred tax liability or asset and recognises the resulting deferred tax expense or income in the income statement (see paragraph 59);
 - (c) if the transaction is not a business combination, and affects neither accounting profit nor taxable profit, an enterprise would, in the absence of the exemption provided by paragraphs 15 and 24, recognise the resulting deferred tax liability or asset and adjust the carrying amount of the asset or liability by the same amount. Such adjustments would make the financial statements less transparent. Therefore, this Standard does not permit an enterprise to recognise the resulting deferred tax liability or asset, either on initial recognition or subsequently (see example on next page). Furthermore, an enterprise does not recognise subsequent changes in the unrecognised deferred tax liability or asset as the asset is depreciated.
23. In accordance with IAS 32, financial instruments: disclosure and presentation, the issuer of a compound financial instrument (for example, a convertible bond) classifies the instrument's liability component as a liability and the equity component as equity. In some jurisdictions, the tax base of the liability component on initial recognition is equal to the initial carrying amount of the sum of the liability and equity components. The resulting taxable temporary difference arises from the initial recognition of the equity component separately from the liability component. Therefore, the exception set out in paragraph 15(b) does not apply. Consequently, an enterprise recognises the resulting deferred tax liability. In accordance with paragraph 61, the deferred tax is charged directly to the carrying amount of the equity component. In accordance with paragraph 58, subsequent changes in the deferred tax liability are recognised in the income statement as deferred tax expense (income).

Example illustrating paragraph 22(c)

An enterprise intends to use an asset which cost 1 000 throughout its useful life of five years and then dispose of it for a residual value of nil. The tax rate is 40 %. Depreciation of the asset is not deductible for tax purposes. On disposal, any capital gain would not be taxable and any capital loss would not be deductible.

As it recovers the carrying amount of the asset, the enterprise will earn taxable income of 1 000 and pay tax of 400. The enterprise does not recognise the resulting deferred tax liability of 400 because it results from the initial recognition of the asset.

In the following year, the carrying amount of the asset is 800. In earning taxable income of 800, the enterprise will pay tax of 320. The enterprise does not recognise the deferred tax liability of 320 because it results from the initial recognition of the asset.

Deductible temporary differences

24. ***A deferred tax asset should be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from:***
- (a) ***negative goodwill which is treated as deferred income in accordance with IAS 22, business combinations; or***

- (b) ***the initial recognition of an asset or liability in a transaction which:***
- (i) ***is not a business combination; and***
 - (ii) ***at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).***

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax asset should be recognised in accordance with paragraph 44.

25. It is inherent in the recognition of a liability that the carrying amount will be settled in future periods through an outflow from the enterprise of resources embodying economic benefits. When resources flow from the enterprise, part or all of their amounts may be deductible in determining taxable profit of a period later than the period in which the liability is recognised. In such cases, a temporary difference exists between the carrying amount of the liability and its tax base. Accordingly, a deferred tax asset arises in respect of the income taxes that will be recoverable in the future periods when that part of the liability is allowed as a deduction in determining taxable profit. Similarly, if the carrying amount of an asset is less than its tax base, the difference gives rise to a deferred tax asset in respect of the income taxes that will be recoverable in future periods.

Example

An enterprise recognises a liability of 100 for accrued product warranty costs. For tax purposes, the product warranty costs will not be deductible until the enterprise pays claims. The tax rate is 25 %.

The tax base of the liability is nil (carrying amount of 100, less the amount that will be deductible for tax purposes in respect of that liability in future periods). In settling the liability for its carrying amount, the enterprise will reduce its future taxable profit by an amount of 100 and, consequently, reduce its future tax payments by 25 (100 at 25 %). The difference between the carrying amount of 100 and the tax base of nil is a deductible temporary difference of 100. Therefore, the enterprise recognises a deferred tax asset of 25 (100 at 25 %), provided that it is probable that the enterprise will earn sufficient taxable profit in future periods to benefit from a reduction in tax payments.

26. The following are examples of deductible temporary differences which result in deferred tax assets:
- (a) retirement benefit costs may be deducted in determining accounting profit as service is provided by the employee, but deducted in determining taxable profit either when contributions are paid to a fund by the enterprise or when retirement benefits are paid by the enterprise. A temporary difference exists between the carrying amount of the liability and its tax base; the tax base of the liability is usually nil. Such a deductible temporary difference results in a deferred tax asset as economic benefits will flow to the enterprise in the form of a deduction from taxable profits when contributions or retirement benefits are paid;
 - (b) research costs are recognised as an expense in determining accounting profit in the period in which they are incurred but may not be permitted as a deduction in determining taxable profit (tax loss) until a later period. The difference between the tax base of the research costs, being the amount the taxation authorities will permit as a deduction in future periods, and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset;
 - (c) in a business combination that is an acquisition, the cost of the acquisition is allocated to the assets and liabilities recognised, by reference to their fair values at the date of the exchange transaction. When a liability is recognised on the acquisition but the related costs are not deducted in determining taxable profits until a later period, a deductible temporary difference arises which results in a deferred tax asset. A deferred tax asset also arises where the fair value of an identifiable asset acquired is less than its tax base. In both cases, the resulting deferred tax asset affects goodwill (see paragraph 66); and

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

27. The reversal of deductible temporary differences results in deductions in determining taxable profits of future periods. However, economic benefits in the form of reductions in tax payments will flow to the enterprise only if it earns sufficient taxable profits against which the deductions can be offset. Therefore, an enterprise recognises deferred tax assets only when it is probable that taxable profits will be available against which the deductible temporary differences can be utilised.

28. It is probable that taxable profit will be available against which a deductible temporary difference can be utilised when there are sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity which are expected to reverse:

(a) in the same period as the expected reversal of the deductible temporary difference; or

(b) in periods into which a tax loss arising from the deferred tax asset can be carried back or forward.

In such circumstances, the deferred tax asset is recognised in the period in which the deductible temporary differences arise.

29. When there are insufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, the deferred tax asset is recognised to the extent that:

(a) it is probable that the enterprise will have sufficient taxable profit relating to the same taxation authority and the same taxable entity in the same period as the reversal of the deductible temporary difference (or in the periods into which a tax loss arising from the deferred tax asset can be carried back or forward). In evaluating whether it will have sufficient taxable profit in future periods, an enterprise ignores taxable amounts arising from deductible temporary differences that are expected to originate in future periods, because the deferred tax asset arising from these deductible temporary differences will itself require future taxable profit in order to be utilised; or

(b) tax planning opportunities are available to the enterprise that will create taxable profit in appropriate periods.

30. Tax planning opportunities are actions that the enterprise would take in order to create or increase taxable income in a particular period before the expiry of a tax loss or tax credit carryforward. For example, in some jurisdictions, taxable profit may be created or increased by:

(a) electing to have interest income taxed on either a received or receivable basis;

(b) deferring the claim for certain deductions from taxable profit;

(c) selling, and perhaps leasing back, assets that have appreciated but for which the tax base has not been adjusted to reflect such appreciation; and

(d) selling an asset that generates non-taxable income (such as, in some jurisdictions, a government bond) in order to purchase another investment that generates taxable income.

Where tax planning opportunities advance taxable profit from a later period to an earlier period, the utilisation of a tax loss or tax credit carryforward still depends on the existence of future taxable profit from sources other than future originating temporary differences.

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

Negative goodwill

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

Initial recognition of an asset or liability

33. One case when a deferred tax asset arises on initial recognition of an asset is when a non-taxable government grant related to an asset is deducted in arriving at the carrying amount of the asset but, for tax purposes, is not deducted from the asset's depreciable amount (in other words its tax base); the carrying amount of the asset is less than its tax base and this gives rise to a deductible temporary difference. Government grants may also be set up as deferred income in which case the difference between the deferred income and its tax base of nil is a deductible temporary difference. Whichever method of presentation an enterprise adopts, the enterprise does not recognise the resulting deferred tax asset, for the reason given in paragraph 22.

Unused tax losses and unused tax credits

34. ***A deferred tax asset should be recognised for the carryforward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised.***
35. The criteria for recognising deferred tax assets arising from the carryforward of unused tax losses and tax credits are the same as the criteria for recognising deferred tax assets arising from deductible temporary differences. However, the existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an enterprise has a history of recent losses, the enterprise recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the enterprise has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the enterprise. In such circumstances, paragraph 82 requires disclosure of the amount of the deferred tax asset and the nature of the evidence supporting its recognition.
36. An enterprise considers the following criteria in assessing the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised:
- (a) whether the enterprise has sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, which will result in taxable amounts against which the unused tax losses or unused tax credits can be utilised before they expire;
 - (b) whether it is probable that the enterprise will have taxable profits before the unused tax losses or unused tax credits expire;
 - (c) whether the unused tax losses result from identifiable causes which are unlikely to recur; and
 - (d) whether tax planning opportunities (see paragraph 30) are available to the enterprise that will create taxable profit in the period in which the unused tax losses or unused tax credits can be utilised.

To the extent that it is not probable that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, the deferred tax asset is not recognised.

IAS 12*Reassessment of unrecognised deferred tax assets*

37. At each balance sheet date, an enterprise reassesses unrecognised deferred tax assets. The enterprise recognises a previously unrecognised deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered. For example, an improvement in trading conditions may make it more probable that the enterprise will be able to generate sufficient taxable profit in the future for the deferred tax asset to meet the recognition criteria set out in paragraphs 24 or 34. Another example is when an enterprise reassesses deferred tax assets at the date of a business combination or subsequently (see paragraphs 67 and 68).

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

38. Temporary differences arise when the carrying amount of investments in subsidiaries, branches and associates or interests in joint ventures (namely the parent or investor's share of the net assets of the subsidiary, branch, associate or investee, including the carrying amount of goodwill) becomes different from the tax base (which is often cost) of the investment or interest. Such differences may arise in a number of different circumstances, for example:
- (a) the existence of undistributed profits of subsidiaries, branches, associates and joint ventures;
 - (b) changes in foreign exchange rates when a parent and its subsidiary are based in different countries; and
 - (c) a reduction in the carrying amount of an investment in an associate to its recoverable amount.

In consolidated financial statements, the temporary difference may be different from the temporary difference associated with that investment in the parent's separate financial statements if the parent carries the investment in its separate financial statements at cost or revalued amount.

39. ***An enterprise should recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, except to the extent that both of the following conditions are satisfied:***
- (a) ***the parent, investor or venturer is able to control the timing of the reversal of the temporary difference; and***
 - (b) ***it is probable that the temporary difference will not reverse in the foreseeable future.***
40. As a parent controls the dividend policy of its subsidiary, it is able to control the timing of the reversal of temporary differences associated with that investment (including the temporary differences arising not only from undistributed profits but also from any foreign exchange translation differences). Furthermore, it would often be impracticable to determine the amount of income taxes that would be payable when the temporary difference reverses. Therefore, when the parent has determined that those profits will not be distributed in the foreseeable future the parent does not recognise a deferred tax liability. The same considerations apply to investments in branches.
41. An enterprise accounts in its own currency for the non-monetary assets and liabilities of a foreign operation that is integral to the enterprise's operations (see IAS 21, the effects of changes in foreign exchange rates). Where the foreign operation's taxable profit or tax loss (and, hence, the tax base of its non-monetary assets and liabilities) is determined in the foreign currency, changes in the exchange rate give rise to temporary differences. Because such temporary differences relate to the foreign operation's own assets and liabilities, rather than to the reporting enterprise's investment in that foreign operation, the reporting enterprise recognises the resulting deferred tax liability or (subject to paragraph 24) asset. The resulting deferred tax is charged or credited in the income statement (see paragraph 58).

42. An investor in an associate does not control that enterprise and is usually not in a position to determine its dividend policy. Therefore, in the absence of an agreement requiring that the profits of the associate will not be distributed in the foreseeable future, an investor recognises a deferred tax liability arising from taxable temporary differences associated with its investment in the associate. In some cases, an investor may not be able to determine the amount of tax that would be payable if it recovers the cost of its investment in an associate, but can determine that it will equal or exceed a minimum amount. In such cases, the deferred tax liability is measured at this amount.
43. The arrangement between the parties to a joint venture usually deals with the sharing of the profits and identifies whether decisions on such matters require the consent of all the venturers or a specified majority of the venturers. When the venturer can control the sharing of profits and it is probable that the profits will not be distributed in the foreseeable future, a deferred tax liability is not recognised.
44. ***An enterprise should recognise a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries, branches and associates, and interests in joint ventures, to the extent that, and only to the extent that, it is probable that:***
- (a) *the temporary difference will reverse in the foreseeable future; and*
- (b) *taxable profit will be available against which the temporary difference can be utilised.*
45. In deciding whether a deferred tax asset is recognised for deductible temporary differences associated with its investments in subsidiaries, branches and associates, and its interests in joint ventures, an enterprise considers the guidance set out in paragraphs 28 to 31.

MEASUREMENT

46. ***Current tax liabilities (assets) for the current and prior periods should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.***
47. ***Deferred tax assets and liabilities should be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.***
48. Current and deferred tax assets and liabilities are usually measured using the tax rates (and tax laws) that have been enacted. However, in some jurisdictions, announcements of tax rates (and tax laws) by the government have the substantive effect of actual enactment, which may follow the announcement by a period of several months. In these circumstances, tax assets and liabilities are measured using the announced tax rate (and tax laws).
49. When different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using the average rates that are expected to apply to the taxable profit (tax loss) of the periods in which the temporary differences are expected to reverse.
50. (Deleted)
51. ***The measurement of deferred tax liabilities and deferred tax assets should reflect the tax consequences that would follow from the manner in which the enterprise expects, at the balance sheet date, to recover or settle the carrying amount of its assets and liabilities.***

IAS 12

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

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

In such cases, an enterprise measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement.

Example A

An asset has a carrying amount of 100 and a tax base of 60. A tax rate of 20 % would apply if the asset were sold and a tax rate of 30 % would apply to other income.

The enterprise recognises a deferred tax liability of 8 (40 at 20 %) if it expects to sell the asset without further use and a deferred tax liability of 12 (40 at 30 %) if it expects to retain the asset and recover its carrying amount through use.

Example B

An asset with a cost of 100 and a carrying amount of 80 is revalued to 150. No equivalent adjustment is made for tax purposes. Cumulative depreciation for tax purposes is 30 and the tax rate is 30 %. If the asset is sold for more than cost, the cumulative tax depreciation of 30 will be included in taxable income but sale proceeds in excess of cost will not be taxable.

The tax base of the asset is 70 and there is a taxable temporary difference of 80. If the enterprise expects to recover the carrying amount by using the asset, it must generate taxable income of 150, but will only be able to deduct depreciation of 70. On this basis, there is a deferred tax liability of 24 (80 at 30 %). If the enterprise expects to recover the carrying amount by selling the asset immediately for proceeds of 150, the deferred tax liability is computed as follows:

	Taxable temporary difference	Tax rate	Deferred tax liability
Cumulative tax depreciation	30	30 %	9
Proceeds in excess of cost	<u>50</u>	nil	<u>—</u>
Total	<u>80</u>		<u>9</u>

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

Example C

The facts are as in example B, except that if the asset is sold for more than cost, the cumulative tax depreciation will be included in taxable income (taxed at 30 %) and the sale proceeds will be taxed at 40 %, after deducting an inflation-adjusted cost of 110.

If the enterprise expects to recover the carrying amount by using the asset, it must generate taxable income of 150, but will only be able to deduct depreciation of 70. On this basis, the tax base is 70, there is a taxable temporary difference of 80 and there is a deferred tax liability of 24 (80 at 30 %), as in example B.

If the enterprise expects to recover the carrying amount by selling the asset immediately for proceeds of 150, the enterprise will be able to deduct the indexed cost of 110. The net proceeds of 40 will be taxed at 40 %. In addition, the cumulative tax depreciation of 30 will be included in taxable income and taxed at 30 %. On this basis, the tax base is 80 (110 less 30), there is a taxable temporary difference of 70 and there is a deferred tax liability of 25 (40 at 40 % plus 30 at 30 %). If the tax base is not immediately apparent in this example, it may be helpful to consider the fundamental principle set out in paragraph 10.

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

- 52A. In some jurisdictions, income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the enterprise. In some other jurisdictions, income taxes may be refundable or payable if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the enterprise. In these circumstances, current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits.
- 52B. In the circumstances described in paragraph 52A, the income tax consequences of dividends are recognised when a liability to pay the dividend is recognised. The income tax consequences of dividends are more directly linked to past transactions or events than to distributions to owners. Therefore, the income tax consequences of dividends are recognised in net profit or loss for the period as required by paragraph 58 except to the extent that the income tax consequences of dividends arise from the circumstances described in paragraph 58(a) and (b).

Example illustrating paragraphs 52A and 52B

The following example deals with the measurement of current and deferred tax assets and liabilities for an enterprise in a jurisdiction where income taxes are payable at a higher rate on undistributed profits (50 %) with an amount being refundable when profits are distributed. The tax rate on distributed profits is 35 %. At the balance sheet date, 31 December 20X1, the enterprise does not recognise a liability for dividends proposed or declared after the balance sheet date. As a result, no dividends are recognised in the year 20X1. Taxable income for 20X1 is 100 000. The net taxable temporary difference for the year 20X1 is 40 000.

The enterprise recognises a current tax liability and a current income tax expense of 50 000. No asset is recognised for the amount potentially recoverable as a result of future dividends. The enterprise also recognises a deferred tax liability and deferred tax expense of 20 000 (40 000 at 50 %) representing the income taxes that the enterprise will pay when it recovers or settles the carrying amounts of its assets and liabilities based on the tax rate applicable to undistributed profits.

Subsequently, on 15 March 20X2 the enterprise recognises dividends of 10 000 from previous operating profits as a liability.

On 15 March 20X2, the enterprise recognises the recovery of income taxes of 1 500 (15 % of the dividends recognised as a liability) as a current tax asset and as a reduction of current income tax expense for 20X2.

53. ***Deferred tax assets and liabilities should not be discounted.***
54. The reliable determination of deferred tax assets and liabilities on a discounted basis requires detailed scheduling of the timing of the reversal of each temporary difference. In many cases such scheduling is impracticable or highly complex. Therefore, it is inappropriate to require discounting of deferred tax assets and liabilities. To permit, but not to require, discounting would result in deferred tax assets and liabilities which would not be comparable between enterprises. Therefore, this Standard does not require or permit the discounting of deferred tax assets and liabilities.

IAS 12

55. Temporary differences are determined by reference to the carrying amount of an asset or liability. This applies even where that carrying amount is itself determined on a discounted basis, for example in the case of retirement benefit obligations (see IAS 19, employee benefits).
56. ***The carrying amount of a deferred tax asset should be reviewed at each balance sheet date. An enterprise should reduce the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilised. Any such reduction should be reversed to the extent that it becomes probable that sufficient taxable profit will be available.***

RECOGNITION OF CURRENT AND DEFERRED TAX

57. Accounting for the current and deferred tax effects of a transaction or other event is consistent with the accounting for the transaction or event itself. Paragraphs 58 to 68 implement this principle.

Income statement

58. ***Current and deferred tax should be recognised as income or an expense and included in the net profit or loss for the period, except to the extent that the tax arises from:***
- (a) ***a transaction or event which is recognised, in the same or a different period, directly in equity (see paragraphs 61 to 65); or***
 - (b) ***a business combination that is an acquisition (see paragraphs 66 to 68).***
59. Most deferred tax liabilities and deferred tax assets arise where income or expense is included in accounting profit in one period, but is included in taxable profit (tax loss) in a different period. The resulting deferred tax is recognised in the income statement. Examples are when:
- (a) interest, royalty or dividend revenue is received in arrears and is included in accounting profit on a time apportionment basis in accordance with IAS 18, revenue, but is included in taxable profit (tax loss) on a cash basis; and
 - (b) costs of intangible assets have been capitalised in accordance with IAS 38, intangible assets, and are being amortised in the income statement, but were deducted for tax purposes when they were incurred.
60. The carrying amount of deferred tax assets and liabilities may change even though there is no change in the amount of the related temporary differences. This can result, for example, from:
- (a) a change in tax rates or tax laws;
 - (b) a reassessment of the recoverability of deferred tax assets; or
 - (c) a change in the expected manner of recovery of an asset.

The resulting deferred tax is recognised in the income statement, except to the extent that it relates to items previously charged or credited to equity (see paragraph 63).

Items credited or charged directly to equity

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

62. International Accounting Standards require or permit certain items to be credited or charged directly to equity. Examples of such items are:
- (a) a change in carrying amount arising from the revaluation of property, plant and equipment (see IAS 16, property, plant and equipment);
 - (b) an adjustment to the opening balance of retained earnings resulting from either a change in accounting policy that is applied retrospectively or the correction of a fundamental error (see IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies);
 - (c) exchange differences arising on the translation of the financial statements of a foreign entity (see IAS 21, the effects of changes in foreign exchange rates); and
 - (d) amounts arising on initial recognition of the equity component of a compound financial instrument (see paragraph 23).
63. In exceptional circumstances it may be difficult to determine the amount of current and deferred tax that relates to items credited or charged to equity. This may be the case, for example, when:
- (a) there are graduated rates of income tax and it is impossible to determine the rate at which a specific component of taxable profit (tax loss) has been taxed;
 - (b) a change in the tax rate or other tax rules affects a deferred tax asset or liability relating (in whole or in part) to an item that was previously charged or credited to equity; or
 - (c) an enterprise determines that a deferred tax asset should be recognised, or should no longer be recognised in full, and the deferred tax asset relates (in whole or in part) to an item that was previously charged or credited to equity.

In such cases, the current and deferred tax related to items that are credited or charged to equity is based on a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction concerned, or other method that achieves a more appropriate allocation in the circumstances.

64. IAS 16, property, plant and equipment, does not specify whether an enterprise should transfer each year from revaluation surplus to retained earnings an amount equal to the difference between the depreciation or amortisation on a revalued asset and the depreciation or amortisation based on the cost of that asset. If an enterprise makes such a transfer, the amount transferred is net of any related deferred tax. Similar considerations apply to transfers made on disposal of an item of property, plant or equipment.
65. When an asset is revalued for tax purposes and that revaluation is related to an accounting revaluation of an earlier period, or to one that is expected to be carried out in a future period, the tax effects of both the asset revaluation and the adjustment of the tax base are credited or charged to equity in the periods in which they occur. However, if the revaluation for tax purposes is not related to an accounting revaluation of an earlier period, or to one that is expected to be carried out in a future period, the tax effects of the adjustment of the tax base are recognised in the income statement.
- 65A. When an enterprise pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders. In many jurisdictions, this amount is referred to as a withholding tax. Such an amount paid or payable to taxation authorities is charged to equity as a part of the dividends.

IAS 12*Deferred tax arising from a business combination*

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

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

Example

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

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

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

PRESENTATION

Tax assets and tax liabilities

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

Offset

71. ***An enterprise should offset current tax assets and current tax liabilities if, and only if, the enterprise:***
- (a) ***has a legally enforceable right to set off the recognised amounts; and***
 - (b) ***intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.***
72. Although current tax assets and liabilities are separately recognised and measured they are offset in the balance sheet subject to criteria similar to those established for financial instruments in IAS 32, financial instruments: disclosure and presentation. An enterprise will normally have a legally enforceable right to set off a current tax asset against a current tax liability when they relate to income taxes levied by the same taxation authority and the taxation authority permits the enterprise to make or receive a single net payment.
73. In consolidated financial statements, a current tax asset of one enterprise in a group is offset against a current tax liability of another enterprise in the group if, and only if, the enterprises concerned have a legally enforceable right to make or receive a single net payment and the enterprises intend to make or receive such a net payment or to recover the asset and settle the liability simultaneously.
74. ***An enterprise should offset deferred tax assets and deferred tax liabilities if, and only if:***
- (a) ***the enterprise has a legally enforceable right to set off current tax assets against current tax liabilities; and***
 - (b) ***the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:***
 - (i) ***the same taxable entity; or***
 - (ii) ***different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.***
75. To avoid the need for detailed scheduling of the timing of the reversal of each temporary difference, this Standard requires an enterprise to set off a deferred tax asset against a deferred tax liability of the same taxable entity if, and only if, they relate to income taxes levied by the same taxation authority and the enterprise has a legally enforceable right to set off current tax assets against current tax liabilities.
76. In rare circumstances, an enterprise may have a legally enforceable right of set-off, and an intention to settle net, for some periods but not for others. In such rare circumstances, detailed scheduling may be required to establish reliably whether the deferred tax liability of one taxable entity will result in increased tax payments in the same period in which a deferred tax asset of another taxable entity will result in decreased payments by that second taxable entity.

IAS 12*Tax expense*

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

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

Exchange differences on deferred foreign tax liabilities or assets

78. IAS 21, the effects of changes in foreign exchange rates, requires certain exchange differences to be recognised as income or expense but does not specify where such differences should be presented in the income statement. Accordingly, where exchange differences on deferred foreign tax liabilities or assets are recognised in the income statement, such differences may be classified as deferred tax expense (income) if that presentation is considered to be the most useful to financial statement users.

Disclosure

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

80. Components of tax expense (income) may include:

- (a) current tax expense (income);
- (b) any adjustments recognised in the period for current tax of prior periods;
- (c) the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences;
- (d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;
- (e) the amount of the benefit arising from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce current tax expense;
- (f) the amount of the benefit from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce deferred tax expense;
- (g) deferred tax expense arising from the write-down, or reversal of a previous write-down, of a deferred tax asset in accordance with paragraph 56; and
- (h) the amount of tax expense (income) relating to those changes in accounting policies and fundamental errors which are included in the determination of net profit or loss for the period in accordance with the allowed alternative treatment in IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies.

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

- (a) ***the aggregate current and deferred tax relating to items that are charged or credited to equity;***
- (b) ***tax expense (income) relating to extraordinary items recognised during the period;***
- (c) ***an explanation of the relationship between tax expense (income) and accounting profit in either or both of the following forms:***
 - (i) ***a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s), disclosing also the basis on which the applicable tax rate(s) is (are) computed; or***

- (ii) *a numerical reconciliation between the average effective tax rate and the applicable tax rate, disclosing also the basis on which the applicable tax rate is computed;*
 - (d) *an explanation of changes in the applicable tax rate(s) compared to the previous accounting period;*
 - (e) *the amount (and expiry date, if any) of deductible temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognised in the balance sheet;*
 - (f) *the aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ventures, for which deferred tax liabilities have not been recognised (see paragraph 39);*
 - (g) *in respect of each type of temporary difference, and in respect of each type of unused tax losses and unused tax credits:*
 - (i) *the amount of the deferred tax assets and liabilities recognised in the balance sheet for each period presented;*
 - (ii) *the amount of the deferred tax income or expense recognised in the income statement, if this is not apparent from the changes in the amounts recognised in the balance sheet;*
 - (h) *in respect of discontinued operations, the tax expense relating to:*
 - (i) *the gain or loss on discontinuance; and*
 - (ii) *the profit or loss from the ordinary activities of the discontinued operation for the period, together with the corresponding amounts for each prior period presented; and*
 - (i) *the amount of income tax consequences of dividends to shareholders of the enterprise that were proposed or declared before the financial statements were authorised for issue, but are not recognised as a liability in the financial statements.*
82. **An enterprise should disclose the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:**
- (a) *the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and*
 - (b) *the enterprise has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates.*
- 82A. **In the circumstances described in paragraph 52A, an enterprise should disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. In addition, the enterprise should disclose the amounts of the potential income tax consequences practicably determinable and whether there are any potential income tax consequences not practicably determinable.**
83. An enterprise discloses the nature and amount of each extraordinary item either on the face of the income statement or in the notes to the financial statements. When this disclosure is made in the notes to the financial statements, the total amount of all extraordinary items is disclosed on the face of the income statement, net of the aggregate related tax expense (income). Although financial statement users may find the disclosure of the tax expense (income) related to each extraordinary item useful, it is sometimes difficult to allocate tax expense (income) between such items. Under these circumstances tax expense (income) relating to extraordinary items may be disclosed in the aggregate.

IAS 12

84. The disclosures required by paragraph 81(c) enable users of financial statements to understand whether the relationship between tax expense (income) and accounting profit is unusual and to understand the significant factors that could affect that relationship in the future. The relationship between tax expense (income) and accounting profit may be affected by such factors as revenue that is exempt from taxation, expenses that are not deductible in determining taxable profit (tax loss), the effect of tax losses and the effect of foreign tax rates.
85. In explaining the relationship between tax expense (income) and accounting profit, an enterprise uses an applicable tax rate that provides the most meaningful information to the users of its financial statements. Often, the most meaningful rate is the domestic rate of tax in the country in which the enterprise is domiciled, aggregating the tax rate applied for national taxes with the rates applied for any local taxes which are computed on a substantially similar level of taxable profit (tax loss). However, for an enterprise operating in several jurisdictions, it may be more meaningful to aggregate separate reconciliations prepared using the domestic rate in each individual jurisdiction. The following example illustrates how the selection of the applicable tax rate affects the presentation of the numerical reconciliation.
86. The average effective tax rate is the tax expense (income) divided by the accounting profit.
87. It would often be impracticable to compute the amount of unrecognised deferred tax liabilities arising from investments in subsidiaries, branches and associates and interests in joint ventures (see paragraph 39). Therefore, this Standard requires an enterprise to disclose the aggregate amount of the underlying temporary differences but does not require disclosure of the deferred tax liabilities. Nevertheless, where practicable, enterprises are encouraged to disclose the amounts of the unrecognised deferred tax liabilities because financial statement users may find such information useful.
- 87A. Paragraph 82A requires an enterprise to disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. An enterprise discloses the important features of the income tax systems and the factors that will affect the amount of the potential income tax consequences of dividends.
- 87B. It would sometimes not be practicable to compute the total amount of the potential income tax consequences that would result from the payment of dividends to shareholders. This may be the case, for example, where an enterprise has a large number of foreign subsidiaries. However, even in such circumstances, some portions of the total amount may be easily determinable. For example, in a consolidated group, a parent and some of its subsidiaries may have paid income taxes at a higher rate on undistributed profits and be aware of the amount that would be refunded on the payment of future dividends to shareholders from consolidated retained earnings. In this case, that refundable amount is disclosed. If applicable, the enterprise also discloses that there are additional potential income tax consequences not practicably determinable. In the parent's separate financial statements, if any, the disclosure of the potential income tax consequences relates to the parent's retained earnings.
- 87C. An enterprise required to provide the disclosures in paragraph 82A may also be required to provide disclosures related to temporary differences associated with investments in subsidiaries, branches and associates or interests in joint ventures. In such cases, an enterprise considers this in determining the information to be disclosed under paragraph 82A. For example, an enterprise may be required to disclose the aggregate amount of temporary differences associated with investments in subsidiaries for which no deferred tax liabilities have been recognised (see paragraph 81(f)). If it is impracticable to compute the amounts of unrecognised deferred tax liabilities (see paragraph 87) there may be amounts of potential income tax consequences of dividends not practicably determinable related to these subsidiaries.
88. An enterprise discloses any tax-related contingent liabilities and contingent assets in accordance with IAS 37, provisions, contingent liabilities and contingent assets. Contingent liabilities and contingent assets may arise, for example, from unresolved disputes with the taxation authorities. Similarly, where changes in tax rates or tax laws are enacted or announced after the balance sheet date, an enterprise discloses any significant effect of those changes on its current and deferred tax assets and liabilities (see IAS 10, events after the balance sheet date).

Example illustrating paragraph 85

In 19X2, an enterprise has accounting profit in its own jurisdiction (country A) of 1 500 (19X1: 2 000) and in country B of 1 500 (19X1: 500). The tax rate is 30 % in country A and 20 % in country B. In country A, expenses of 100 (19X1: 200) are not deductible for tax purposes.

The following is an example of a reconciliation to the domestic tax rate.

	19X1	19X2
Accounting profit	<u>2 500</u>	<u>3 000</u>
Tax at the domestic rate of 30 %	750	900
Tax effect of expenses that are not deductible for tax purposes	60	30
Effect of lower tax rates in country B	<u>(50)</u>	<u>(150)</u>
Tax expense	<u>760</u>	<u>780</u>

The following is an example of a reconciliation prepared by aggregating separate reconciliations for each national jurisdiction. Under this method, the effect of differences between the reporting enterprise's own domestic tax rate and the domestic tax rate in other jurisdictions does not appear as a separate item in the reconciliation. An enterprise may need to discuss the effect of significant changes in either tax rates, or the mix of profits earned in different jurisdictions, in order to explain changes in the applicable tax rate(s), as required by paragraph 81(d).

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

EFFECTIVE DATE

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

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

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

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

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

INTRODUCTION

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

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

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

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

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

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

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

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

OBJECTIVE

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

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

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

SCOPE

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

DEFINITIONS

Definitions from other international accounting standards

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

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

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

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

Definitions of business segment and geographical segment

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Segment assets do not include income tax assets.

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

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

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

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

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

Segment liabilities do not include income tax liabilities.

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

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

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

IDENTIFYING REPORTABLE SEGMENTS

Primary and secondary segment reporting formats

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

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

Business and geographical segments

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

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

Reportable segments

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

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

SEGMENT ACCOUNTING POLICIES

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

DISCLOSURE

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

Primary reporting format

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

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

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

Secondary segment information

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

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

Illustrative segment disclosures

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

Other disclosure matters

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

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

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

EFFECTIVE DATE

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

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

Information reflecting the effects of changing prices

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

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BOARD STATEMENT OCTOBER 1989

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

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

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

SCOPE

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

EXPLANATION

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

RESPONDING TO CHANGING PRICES

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

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

General purchasing power approach

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

Current cost approach

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

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

Current status

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

MINIMUM DISCLOSURES

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

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OTHER DISCLOSURES

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

EFFECTIVE DATE

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

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

Property, plant and equipment

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

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

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

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

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

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

The following SIC interpretations relate to IAS 16:

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

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

OBJECTIVE

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

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

SCOPE

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

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

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

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

DEFINITIONS

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

Property, plant and equipment are tangible assets that:

- (a) **are held by an enterprise for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and**
- (b) **are expected to be used during more than one period.**

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

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

Useful life is either:

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

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

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

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

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

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

RECOGNITION OF PROPERTY, PLANT AND EQUIPMENT

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

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

INITIAL MEASUREMENT OF PROPERTY, PLANT AND EQUIPMENT

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

Components of cost

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

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

Exchanges of assets

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

SUBSEQUENT EXPENDITURE

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

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

MEASUREMENT SUBSEQUENT TO INITIAL RECOGNITION

Benchmark treatment

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

Allowed alternative treatment

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

Revaluations

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

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

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

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

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

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

DEPRECIATION

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

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

Review of Useful Life

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

Review of depreciation method

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

RECOVERABILITY OF THE CARRYING AMOUNT — IMPAIRMENT LOSSES

53. To determine whether an item of property, plant and equipment is impaired, an enterprise applies IAS 36, impairment of assets. That Standard explains how an enterprise reviews the carrying amount of its assets, how it determines the recoverable amount of an asset and when it recognises or reverses an impairment loss⁽¹⁾.

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

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

RETIREMENTS AND DISPOSALS

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

DISCLOSURE

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

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

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

Therefore, enterprises are encouraged to disclose these amounts.

EFFECTIVE DATE

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

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

Leases

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

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

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

The following SIC interpretations relate to IAS 17:

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

INTRODUCTION

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

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

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

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

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

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

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

New disclosures required by IAS 17 (revised) include:

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

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

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

OBJECTIVE

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

SCOPE

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

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

- (a) *lessees of investment property held under finance leases (See IAS 40, investment property);*
 - (b) *lessors of investment property leased out under operating leases (see IAS 40, investment property);*
 - (c) *lessees of biological assets held under finance leases (see IAS 41, agriculture); or*
 - (d) *lessors of biological assets leased out under operating leases (see IAS 41, agriculture).*
2. This Standard applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. On the other hand, this Standard does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

DEFINITIONS

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

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

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

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

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

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

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

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

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

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

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

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

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

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

Economic life is either:

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

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

Guaranteed residual value is:

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

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

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

Unearned finance income is the difference between:

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

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

The interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of (a) the minimum lease payments and (b) the unguaranteed residual value to be equal to the fair value of the leased asset.

The lessee's incremental borrowing rate of interest is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

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

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

CLASSIFICATION OF LEASES

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

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

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

LEASES IN THE FINANCIAL STATEMENTS OF LESSEES

Finance leases

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

IAS 17

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

Operating leases

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

LEASES IN THE FINANCIAL STATEMENTS OF LESSORS

Finance leases

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

⁽²⁾ See also SIC-15: operating leases — incentives.

IAS 17

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

(e) *contingent rents recognised in income; and*

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

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

Operating leases

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

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

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

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

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

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

47. A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.

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

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

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

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

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

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

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

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

⁽³⁾ See also SIC-15: operating leases — incentives.

IAS 17

SALE AND LEASEBACK TRANSACTIONS

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

TRANSITIONAL PROVISIONS

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

EFFECTIVE DATE

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

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

Revenue

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

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

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

The following SIC interpretations relate to IAS 18:

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

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

OBJECTIVE

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

IAS 18

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

SCOPE

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

DEFINITIONS

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

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

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

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

MEASUREMENT OF REVENUE

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

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

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

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

IAS 18

IDENTIFICATION OF THE TRANSACTION

13. The recognition criteria in this Standard are usually applied separately to each transaction. However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognised as revenue over the period during which the service is performed. Conversely, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole. For example, an enterprise may sell goods and, at the same time, enter into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction; in such a case, the two transactions are dealt with together.

SALE OF GOODS

14. **Revenue from the sale of goods should be recognised when all the following conditions have been satisfied:**
- (a) ***the enterprise has transferred to the buyer the significant risks and rewards of ownership of the goods;***
 - (b) ***the enterprise retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;***
 - (c) ***the amount of revenue can be measured reliably;***
 - (d) ***it is probable that the economic benefits associated with the transaction will flow to the enterprise;***
and
 - (e) ***the costs incurred or to be incurred in respect of the transaction can be measured reliably.***
15. The assessment of when an enterprise has transferred the significant risks and rewards of ownership to the buyer requires an examination of the circumstances of the transaction. In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the buyer. This is the case for most retail sales. In other cases, the transfer of risks and rewards of ownership occurs at a different time from the transfer of legal title or the passing of possession.
16. If the enterprise retains significant risks of ownership, the transaction is not a sale and revenue is not recognised. An enterprise may retain a significant risk of ownership in a number of ways. Examples of situations in which the enterprise may retain the significant risks and rewards of ownership are:
- (a) when the enterprise retains an obligation for unsatisfactory performance not covered by normal warranty provisions;
 - (b) when the receipt of the revenue from a particular sale is contingent on the derivation of revenue by the buyer from its sale of the goods;
 - (c) when the goods are shipped subject to installation and the installation is a significant part of the contract which has not yet been completed by the enterprise; and
 - (d) when the buyer has the right to rescind the purchase for a reason specified in the sales contract and the enterprise is uncertain about the probability of return.
17. If an enterprise retains only an insignificant risk of ownership, the transaction is a sale and revenue is recognised. For example, a seller may retain the legal title to the goods solely to protect the collectability of the amount due. In such a case, if the enterprise has transferred the significant risks and rewards of ownership, the transaction is a sale and revenue is recognised. Another example of an enterprise retaining only an insignificant risk of ownership may be a retail sale when a refund is offered if the customer is not satisfied. Revenue in such cases is recognised at the time of sale provided the seller can reliably estimate future returns and recognises a liability for returns based on previous experience and other relevant factors.

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

RENDERING OF SERVICES

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

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

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

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

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

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

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

INTEREST, ROYALTIES AND DIVIDENDS

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

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

DISCLOSURE

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

EFFECTIVE DATE

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

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

Employee Benefits

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

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

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

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

INTRODUCTION

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

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

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

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

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

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

OBJECTIVE

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

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

SCOPE

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

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

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

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

DEFINITIONS

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

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

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

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

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

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

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

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

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

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

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

- (a) an enterprise's decision to terminate an employee's employment before the normal retirement date; or*
- (b) an employee's decision to accept voluntary redundancy in exchange for those benefits.*

Equity compensation benefits are employee benefits under which either:

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

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

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

The present value of a defined benefit obligation is the present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.

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

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

Plan assets comprise:

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

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

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

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

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

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

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

Actuarial gains and losses comprise:

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

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

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SHORT-TERM EMPLOYEE BENEFITS

8. Short-term employee benefits include items such as:
- (a) wages, salaries and social security contributions;
 - (b) short-term compensated absences (such as paid annual leave and paid sick leave) where the absences are expected to occur within 12 months after the end of the period in which the employees render the related employee service;
 - (c) profit-sharing and bonuses payable within 12 months after the end of the period in which the employees render the related service; and
 - (d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.
9. Accounting for short-term employee benefits is generally straightforward because no actuarial assumptions are required to measure the obligation or the cost and there is no possibility of any actuarial gain or loss. Moreover, short-term employee benefit obligations are measured on an undiscounted basis.

Recognition and measurement

All short-term employee benefits

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

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

Short-term compensated absences

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

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

Example illustrating paragraphs 14 and 15

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

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

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

Profit-sharing and bonus plans

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

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

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

Example illustrating paragraph 18

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

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

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

Disclosure

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

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

24. Post-employment benefits include, for example:
- (a) retirement benefits, such as pensions; and
 - (b) other post-employment benefits, such as post-employment life insurance and post-employment medical care.

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

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

Multi-employer plans

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

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

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

State plans

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

Insured benefits

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

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

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

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

POST-EMPLOYMENT BENEFITS: DEFINED CONTRIBUTION PLANS

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

Recognition and measurement

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

Disclosure

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

POST-EMPLOYMENT BENEFITS: DEFINED BENEFIT PLANS

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

Recognition and measurement

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

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

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

Accounting for the constructive obligation

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

Balance sheet

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

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

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

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

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

Example illustrating paragraph 60

A defined benefit plan has the following characteristics:

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

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

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Income statement

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

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

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

Actuarial valuation method

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

Example illustrating paragraph 65

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

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

Note:

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

Attributing benefit to periods of service

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

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Examples illustrating paragraph 68

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

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

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

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

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

69. Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words they are not vested). Employee service before the vesting date gives rise to a constructive obligation because, at each successive balance sheet date, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced. In measuring its defined benefit obligation, an enterprise considers the probability that some employees may not satisfy any vesting requirements. Similarly, although certain post-employment benefits, for example, post-employment medical benefits, become payable only if a specified event occurs when an employee is no longer employed, an obligation is created when the employee renders service that will provide entitlement to the benefit if the specified event occurs. The probability that the specified event will occur affects the measurement of the obligation, but does not determine whether the obligation exists.

Examples illustrating paragraph 69

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

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

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

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

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

Examples illustrating paragraph 70

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Example illustrating paragraph 71

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

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

Actuarial assumptions

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

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

Actuarial assumptions: discount rate

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

Actuarial assumptions: salaries, benefits and medical costs

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

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

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

Actuarial gains and losses

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

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

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

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

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Past service cost

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

Example illustrating paragraph 97

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

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

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

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

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

Recognition and measurement: plan assets

Fair value of plan assets

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

Reimbursements

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

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

Example illustrating paragraphs 104A-C

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

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

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

Return on plan assets

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

Example illustrating paragraph 106

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

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

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

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

Business combinations

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

Curtailments and settlements

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

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

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

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

Example illustrating paragraph 115

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

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

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

*Presentation**Offset*

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

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

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

Current/non-current distinction

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

Financial components of post-employment benefit costs

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

Disclosure

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

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

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

- (iii) *the expected rates of return for the periods presented in the financial statements on any reimbursement right recognised as an asset under paragraph 104A;*
- (iv) *the expected rates of salary increases (and of changes in an index or other variable specified in the formal or constructive terms of a plan as the basis for future benefit increases);*
- (v) *medical cost trend rates; and*
- (vi) *any other material actuarial assumptions used.*

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

121. Paragraph 120(b) requires a general description of the type of plan. Such a description distinguishes, for example, flat salary pension plans from final salary pension plans and from post-employment medical plans. Further detail is not required.
122. When an enterprise has more than one defined benefit plan, disclosures may be made in total, separately for each plan, or in such groupings as are considered to be the most useful. It may be useful to distinguish groupings by criteria such as the following:
- (a) the geographical location of the plans, for example, by distinguishing domestic plans from foreign plans; or
 - (b) whether plans are subject to materially different risks, for example, by distinguishing flat salary pension plans from final salary pension plans and from post-employment medical plans.
- When an enterprise provides disclosures in total for a grouping of plans, such disclosures are provided in the form of weighted averages or of relatively narrow ranges.
123. Paragraph 30 requires additional disclosures about multi-employer defined benefit plans that are treated as if they were defined contribution plans.
124. Where required by IAS 24, related party disclosures, an enterprise discloses information about:
- (a) related party transactions with post-employment benefit plans; and
 - (b) post-employment benefits for key management personnel.
125. Where required by IAS 37, provisions, contingent liabilities and contingent assets, an enterprise discloses information about contingent liabilities arising from post-employment benefit obligations.

OTHER LONG-TERM EMPLOYEE BENEFITS

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

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

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

Recognition and measurement

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

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

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

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

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

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

Disclosure

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

TERMINATION BENEFITS

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

Recognition

133. **An enterprise should recognise termination benefits as a liability and an expense when, and only when, the enterprise is demonstrably committed to either:**

- (a) **terminate the employment of an employee or group of employees before the normal retirement date; or**
- (b) **provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.**

134. **An enterprise is demonstrably committed to a termination when, and only when, the enterprise has a detailed formal plan for the termination and is without realistic possibility of withdrawal. The detailed plan should include, as a minimum:**

- (a) **the location, function, and approximate number of employees whose services are to be terminated;**
- (b) **the termination benefits for each job classification or function; and**
- (c) **the time at which the plan will be implemented. Implementation should begin as soon as possible and the period of time to complete implementation should be such that material changes to the plan are not likely.**

135. An enterprise may be committed, by legislation, by contractual or other agreements with employees or their representatives or by a constructive obligation based on business practice, custom or a desire to act equitably, to make payments (or provide other benefits) to employees when it terminates their employment. Such payments are termination benefits. Termination benefits are typically lump-sum payments, but sometimes also include:

- (a) enhancement of retirement benefits or of other post-employment benefits, either indirectly through an employee benefit plan or directly; and
- (b) salary until the end of a specified notice period if the employee renders no further service that provides economic benefits to the enterprise.

136. Some employee benefits are payable regardless of the reason for the employee's departure. The payment of such benefits is certain (subject to any vesting or minimum service requirements) but the timing of their payment is uncertain. Although such benefits are described in some countries as termination indemnities, or termination gratuities, they are post-employment benefits, rather than termination benefits and an enterprise accounts for them as post-employment benefits. Some enterprises provide a lower level of benefit for voluntary termination at the request of the employee (in substance, a post-employment benefit) than for involuntary termination at the request of the enterprise. The additional benefit payable on involuntary termination is a termination benefit.

137. Termination benefits do not provide an enterprise with future economic benefits and are recognised as an expense immediately.

138. Where an enterprise recognises termination benefits, the enterprise may also have to account for a curtailment of retirement benefits or other employee benefits (see paragraph 109).

IAS 19*Measurement*

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

Disclosure

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

EQUITY COMPENSATION BENEFITS

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

Recognition and measurement

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

Disclosure

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

147. **An enterprise should disclose:**

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

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

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

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

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

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

IAS 19

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

TRANSITIONAL PROVISIONS

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

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

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

Example illustrating paragraphs 154 to 156

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

The transitional effect is as follows:

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

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

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

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

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

EFFECTIVE DATE

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

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

IAS 20

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

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

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

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

Accounting for government grants and disclosure of government assistance

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

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

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

One SIC interpretation relates to IAS 20:

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

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

IAS 20

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

SCOPE

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

DEFINITIONS

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

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

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

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

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

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

IAS 20

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

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

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

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

GOVERNMENT GRANTS

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

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

IAS 20*Non-monetary government grants*

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

Presentation of grants related to assets

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

Presentation of grants related to income

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

Repayment of government grants

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

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

GOVERNMENT ASSISTANCE

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

DISCLOSURE

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

TRANSITIONAL PROVISIONS

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

EFFECTIVE DATE

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

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.

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IAS 21

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

OBJECTIVE

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

- This Standard should be applied:***
 - in accounting for transactions in foreign currencies; and***
 - 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⁾.***
- 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.
- This Standard supersedes IAS 21, accounting for the effects of changes in foreign exchange rates, approved in 1983.
- 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⁾.

⁽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.

IAS 21

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.

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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.

⁽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

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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.

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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.

⁽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.

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

OBJECTIVE

The objective of this Standard is to prescribe the accounting treatment for 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-subsidary 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).

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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.

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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.

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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.

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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.

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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.***

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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.

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- (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.

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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.*

IAS 22

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: <ol style="list-style-type: none"> (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.

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|--|---|--|
| (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. | <p>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).</p> <p>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.</p> <p>For the amortisation of goodwill (recognition of negative goodwill as income), see circumstances 3 or 4.</p> |
| 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. | <p>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.</p> <p>Otherwise:</p> <ul style="list-style-type: none"> (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: | Restatement of the negative goodwill is encouraged, but not required. If the negative goodwill is restated: |
| (i) | the cost of the acquisition was less than the acquirer's interest in the fair value of the identifiable assets and liabilities; and | (i) restate negative goodwill for all acquisitions after 1 January 1995; |
| (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)). | <ul style="list-style-type: none"> (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). |

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	<p>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.</p>
<p>(c) At the date of acquisition:</p> <p>(i) the cost of the acquisition was less than the acquirer's interest in the fair value of the identifiable assets and liabilities; and</p> <p>(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)).</p>	<p>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:</p> <p>(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;</p> <p>(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</p> <p>(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).</p>
<p>3. Goodwill was recognised as an asset but was not previously amortised or the amortisation charge was deemed to be nil.</p> <p>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.</p>	<p>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)).</p>
<p>4. Goodwill (negative goodwill) was previously amortised (recognised as income).</p>	<p>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:</p> <p>(i) amortise any carrying amount of the goodwill over its remaining useful life determined under this Standard (see paragraphs 44 to 54); and</p> <p>(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)).</p> <p>(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).</p>

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.

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

OBJECTIVE

The objective of this Standard is to prescribe the accounting treatment for 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.

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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.**

IAS 24

INTERNATIONAL ACCOUNTING STANDARD IAS 24
(REFORMATED 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.

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

SCOPE

1. ***This Standard should be applied in 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);

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- (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.

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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.

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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.

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

SCOPE

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

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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.***

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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

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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.***

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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

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

SCOPE

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

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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

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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.

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

SCOPE

1. ***This Standard should be applied in accounting 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.

IAS 28

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.

IAS 28

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.

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

SCOPE

- 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.***
- 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.
- 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:
 - 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;
 - 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;
 - 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;
 - interest rates, wages and prices are linked to a price index; and
 - the cumulative inflation rate over three years is approaching, or exceeds, 100 %.
- 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

- 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.
- 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 unrevised 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

B a l a n c e s h e e t

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.

IAS 29

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.

IAS 30

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.

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

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

SCOPE

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

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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.

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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.

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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.***

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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;

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

SCOPE

1. ***This Standard should be applied in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place.***

DEFINITIONS

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

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity which is subject to joint control.

Control is the power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.

Joint control is the contractually agreed sharing of control over an economic activity.

Significant influence is the power to participate in the financial and operating policy decisions of an economic activity but is not control or joint control over those policies.

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

An investor in a joint venture is a party to a joint venture and does not have joint control over that joint venture.

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Proportionate consolidation is a method of accounting and reporting whereby a venturer's share of each of the assets, liabilities, income and expenses of a jointly controlled entity is combined on a line-by-line basis with similar items in the venturer's financial statements or reported as separate line items in the venturer's financial statements.

The equity method is a method of accounting and reporting whereby an interest in a jointly controlled entity is initially recorded at cost and adjusted thereafter for the post acquisition change in the venturer's share of net assets of the jointly controlled entity. The income statement reflects the venturer's share of the results of operations of the jointly controlled entity.

Forms of joint venture

3. Joint ventures take many different forms and structures. This Standard identifies three broad types — jointly controlled operations, jointly controlled assets and jointly controlled entities — which are commonly described as, and meet the definition of, joint ventures. The following characteristics are common to all joint ventures:
 - (a) two or more venturers are bound by a contractual arrangement; and
 - (b) the contractual arrangement establishes joint control.

Contractual arrangement

4. The existence of a contractual arrangement distinguishes interests which involve joint control from investments in associates in which the investor has significant influence (see IAS 28, accounting for investments in associates). Activities which have no contractual arrangement to establish joint control are not joint ventures for the purposes of this Standard.
5. The contractual arrangement may be evidenced in a number of ways, for example by a contract between the venturers or minutes of discussions between the venturers. In some cases, the arrangement is incorporated in the articles or other by-laws of the joint venture. Whatever its form, the contractual arrangement is usually in writing and deals with such matters as:
 - (a) the activity, duration and reporting obligations of the joint venture;
 - (b) the appointment of the board of directors or equivalent governing body of the joint venture and the voting rights of the venturers;
 - (c) capital contributions by the venturers; and
 - (d) the sharing by the venturers of the output, income, expenses or results of the joint venture.
6. The contractual arrangement establishes joint control over the joint venture. Such a requirement ensures that no single venturer is in a position to control unilaterally the activity. The arrangement identifies those decisions in areas essential to the goals of the joint venture which require the consent of all the venturers and those decisions which may require the consent of a specified majority of the venturers.
7. The contractual arrangement may identify one venturer as the operator or manager of the joint venture. The operator does not control the joint venture but acts within the financial and operating policies which have been agreed by the venturers in accordance with the contractual arrangement and delegated to the operator. If the operator has the power to govern the financial and operating policies of the economic activity, it controls the venture and the venture is a subsidiary of the operator and not a joint venture.

JOINTLY CONTROLLED OPERATIONS

8. The operation of some joint ventures involves the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer uses its own property, plant and equipment and carries its own inventories. It also incurs its own expenses and liabilities and raises its own finance, which represent its own obligations. The joint venture activities may be carried out by the venturer's employees alongside the venturer's similar activities. The joint venture agreement usually provides a means by which the revenue from the sale of the joint product and any expenses incurred in common are shared among the venturers.
9. An example of a jointly controlled operation is when two or more venturers combine their operations, resources and expertise in order to manufacture, market and distribute jointly a particular product, such as an aircraft. Different parts of the manufacturing process are carried out by each of the venturers. Each venturer bears its own costs and takes a share of the revenue from the sale of the aircraft, such share being determined in accordance with the contractual arrangement.
10. ***In respect of its interests in jointly controlled operations, a venturer should recognise in its separate financial statements and consequently in its consolidated financial statements:***
 - (a) ***the assets that it controls and the liabilities that it incurs; and***
 - (b) ***the expenses that it incurs and its share of the income that it earns from the sale of goods or services by the joint venture.***
11. Because the assets, liabilities, income and expenses are already recognised in the separate financial statements of the venturer, and consequently in its consolidated financial statements, no adjustments or other consolidation procedures are required in respect of these items when the venturer presents consolidated financial statements.
12. Separate accounting records may not be required for the joint venture itself and financial statements may not be prepared for the joint venture. However, the venturers may prepare management accounts so that they may assess the performance of the joint venture.

JOINTLY CONTROLLED ASSETS

13. Some joint ventures involve the joint control, and often the joint ownership, by the venturers of one or more assets contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture. The assets are used to obtain benefits for the venturers. Each venturer may take a share of the output from the assets and each bears an agreed share of the expenses incurred.
14. These joint ventures do not involve the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer has control over its share of future economic benefits through its share in the jointly controlled asset.
15. Many activities in the oil, gas and mineral extraction industries involve jointly controlled assets; for example, a number of oil production companies may jointly control and operate an oil pipeline. Each venturer uses the pipeline to transport its own product in return for which it bears an agreed proportion of the expenses of operating the pipeline. Another example of a jointly controlled asset is when two enterprises jointly control a property, each taking a share of the rents received and bearing a share of the expenses.
16. ***In respect of its interest in jointly controlled assets, a venturer should recognise in its separate financial statements and consequently in its consolidated financial statements:***
 - (a) ***its share of the jointly controlled assets, classified according to the nature of the assets;***
 - (b) ***any liabilities which it has incurred;***

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- (c) *its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;*
 - (d) *any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and*
 - (e) *any expenses which it has incurred in respect of its interest in the joint venture.*
17. In respect of its interest in jointly controlled assets, each venturer includes in its accounting records and recognises in its separate financial statements and consequently in its consolidated financial statements:
- (a) its share of the jointly controlled assets, classified according to the nature of the assets rather than as an investment. For example, a share of a jointly controlled oil pipeline is classified as property, plant and equipment;
 - (b) any liabilities which it has incurred, for example those incurred in financing its share of the assets;
 - (c) its share of any liabilities incurred jointly with other venturers in relation to the joint venture;
 - (d) any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and
 - (e) any expenses which it has incurred in respect of its interest in the joint venture, for example those related to financing the venturer's interest in the assets and selling its share of the output.

Because the assets, liabilities, income and expenses are already recognised in the separate financial statements of the venturer, and consequently in its consolidated financial statements, no adjustments or other consolidation procedures are required in respect of these items when the venturer presents consolidated financial statements.

18. The treatment of jointly controlled assets reflects the substance and economic reality and, usually, the legal form of the joint venture. Separate accounting records for the joint venture itself may be limited to those expenses incurred in common by the venturers and ultimately borne by the venturers according to their agreed shares. Financial statements may not be prepared for the joint venture, although the venturers may prepare management accounts so that they may assess the performance of the joint venture.

JOINTLY CONTROLLED ENTITIES

19. A jointly controlled entity is a joint venture which involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other enterprises, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity.
20. A jointly controlled entity controls the assets of the joint venture, incurs liabilities and expenses and earns income. It may enter into contracts in its own name and raise finance for the purposes of the joint venture activity. Each venturer is entitled to a share of the results of the jointly controlled entity, although some jointly controlled entities also involve a sharing of the output of the joint venture.
21. A common example of a jointly controlled entity is when two enterprises combine their activities in a particular line of business by transferring the relevant assets and liabilities into a jointly controlled entity. Another example arises when an enterprise commences a business in a foreign country in conjunction with the government or other agency in that country, by establishing a separate entity which is jointly controlled by the enterprise and the government or agency.

22. Many jointly controlled entities are similar in substance to those joint ventures referred to as jointly controlled operations or jointly controlled assets. For example, the venturers may transfer a jointly controlled asset, such as an oil pipeline, into a jointly controlled entity, for tax or other reasons. Similarly, the venturers may contribute into a jointly controlled entity assets which will be operated jointly. Some jointly controlled operations also involve the establishment of a jointly controlled entity to deal with particular aspects of the activity, for example, the design, marketing, distribution or after-sales service of the product.
23. A jointly controlled entity maintains its own accounting records and prepares and presents financial statements in the same way as other enterprises in conformity with the appropriate national requirements and International Accounting Standards.
24. Each venturer usually contributes cash or other resources to the jointly controlled entity. These contributions are included in the accounting records of the venturer and recognised in its separate financial statements as an investment in the jointly controlled entity.

Consolidated financial statements of a venturer

Benchmark treatment — proportionate consolidation

25. ***In its consolidated financial statements, a venturer should report its interest in a jointly controlled entity using one of the two reporting formats for proportionate consolidation.***
26. When reporting an interest in a jointly controlled entity in consolidated financial statements, it is essential that a venturer reflects the substance and economic reality of the arrangement, rather than the joint venture's particular structure or form. In a jointly controlled entity, a venturer has control over its share of future economic benefits through its share of the assets and liabilities of the venture. This substance and economic reality is reflected in the consolidated financial statements of the venturer when the venturer reports its interests in the assets, liabilities, income and expenses of the jointly controlled entity by using one of the two reporting formats for proportionate consolidation described in paragraph 28.
27. The application of proportionate consolidation means that the consolidated balance sheet of the venturer includes its share of the assets that it controls jointly and its share of the liabilities for which it is jointly responsible. The consolidated income statement of the venturer includes its share of the income and expenses of the jointly controlled entity. Many of the procedures appropriate for the application of proportionate consolidation are similar to the procedures for the consolidation of investments in subsidiaries, which are set out in IAS 27, consolidated financial statements and accounting for investments in subsidiaries.
28. Different reporting formats may be used to give effect to proportionate consolidation. The venturer may combine its share of each of the assets, liabilities, income and expenses of the jointly controlled entity with the similar items in its consolidated financial statements on a line-by-line basis. For example, it may combine its share of the jointly controlled entity's inventory with the inventory of the consolidated group and its share of the jointly controlled entity's property, plant and equipment with the same items of the consolidated group. Alternatively, the venturer may include separate line items for its share of the assets, liabilities, income and expenses of the jointly controlled entity in its consolidated financial statements. For example, it may show its share of the current assets of the jointly controlled entity separately as part of the current assets of the consolidated group; it may show its share of the property, plant and equipment of the jointly controlled entity separately as part of the property, plant and equipment of the consolidated group. Both these reporting formats result in the reporting of identical amounts of net income and of each major classification of assets, liabilities, income and expenses; both formats are acceptable for the purposes of this Standard.
29. Whatever format is used to give effect to proportionate consolidation, it is inappropriate to offset any assets or liabilities by the deduction of other liabilities or assets or any income or expenses by the deduction of other expenses or income, unless a legal right of set-off exists and the offsetting represents the expectation as to the realisation of the asset or the settlement of the liability.

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30. ***A venturer should discontinue the use of proportionate consolidation from the date on which it ceases to have joint control over a jointly controlled entity.***
31. A venturer discontinues the use of proportionate consolidation from the date on which it ceases to share in the control of a jointly controlled entity. This may happen, for example, when the venturer disposes of its interest or when external restrictions are placed on the jointly controlled entity such that it can no longer achieve its goals.

Allowed alternative treatment — equity method

32. ***In its consolidated financial statements, a venturer should report its interest in a jointly controlled entity using the equity method.***
33. Some venturers report their interests in jointly controlled entities using the equity method, as described in IAS 28, accounting for investments in associates. The use of the equity method is supported by those who argue that it is inappropriate to combine controlled items with jointly controlled items and by those who believe that venturers have significant influence, rather than joint control, in a jointly controlled entity. This Standard does not recommend the use of the equity method because proportionate consolidation better reflects the substance and economic reality of a venturer's interest in a jointly controlled entity, that is control over the venturer's share of the future economic benefits. Nevertheless, this Standard permits the use of the equity method, as an allowed alternative treatment, when reporting interests in jointly controlled entities.
34. ***A venturer should discontinue the use of the equity method from the date on which it ceases to have joint control over, or have significant influence in, a jointly controlled entity.***

Exceptions to benchmark and allowed alternative treatments

35. ***A venturer should account for the following interests in accordance with IAS 39, financial instruments: recognition and measurement:***
- (a) ***an interest in a jointly controlled entity which is acquired and held exclusively with a view to its subsequent disposal in the near future; and***
 - (b) ***an interest in a jointly controlled entity which operates under severe long-term restrictions that significantly impair its ability to transfer funds to the venturer.***
36. The use of either proportionate consolidation or the equity method is inappropriate when the interest in a jointly controlled entity is acquired and held exclusively with a view to its subsequent disposal in the near future. It is also inappropriate when the jointly controlled entity operates under severe long-term restrictions which significantly impair its ability to transfer funds to the venturer.
37. ***From the date on which a jointly controlled entity becomes a subsidiary of a venturer, the venturer accounts for its interest in accordance with IAS 27, consolidated financial statements and accounting for investments in subsidiaries.***

Separate financial statements of a venturer

38. In many countries separate financial statements are presented by a venturer in order to meet legal or other requirements. Such separate financial statements are prepared in order to meet a variety of needs with the result that different reporting practices are in use in different countries. Accordingly, this Standard does not indicate a preference for any particular treatment.

TRANSACTIONS BETWEEN A VENTURER AND A JOINT VENTURE

39. *When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction should reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer should recognise only that portion of the gain or loss which is attributable to the interests of the other venturers⁽¹⁾. The venturer should recognise the full amount of any loss when the contribution or sale provides evidence of a reduction in the net realisable value of current assets or an impairment loss.*
40. *When a venturer purchases assets from a joint venture, the venturer should not recognise its share of the profits of the joint venture from the transaction until it resells the assets to an independent party. A venturer should recognise its share of the losses resulting from these transactions in the same way as profits except that losses should be recognised immediately when they represent a reduction in the net realisable value of current assets or an impairment loss.*
41. To assess whether a transaction between a venturer and a joint venture provides evidence of impairment of an asset, the venturer determines the recoverable amount of the asset under IAS 36, impairment of assets. In determining value in use, future cash flows from the asset are estimated based on continuing use of the asset and its ultimate disposal by the joint venture.

REPORTING INTERESTS IN JOINT VENTURES IN THE FINANCIAL STATEMENTS OF AN INVESTOR

42. *An investor in a joint venture, which does not have joint control, should report its interest in a joint venture in its consolidated financial statements in accordance with IAS 39, financial instruments: recognition and measurement, or, if it has significant influence in the joint venture, in accordance with IAS 28, accounting for investments in associates. In the separate financial statements of an investor that issues consolidated financial statements, it may also report the investment at cost.*

OPERATORS OF JOINT VENTURES

43. *Operators or managers of a joint venture should account for any fees in accordance with IAS 18, revenue.*
44. One or more venturers may act as the operator or manager of a joint venture. Operators are usually paid a management fee for such duties. The fees are accounted for by the joint venture as an expense.

DISCLOSURE

45. *A venturer should disclose the aggregate amount of the following contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities:*
- (a) *any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities which have been incurred jointly with other venturers;*
 - (b) *its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and*
 - (c) *those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture.*

⁽¹⁾ See also SIC-13: jointly controlled entities — non-monetary contributions by venturers.

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46. *A venturer should disclose the aggregate amount of the following commitments in respect of its interests in joint ventures separately from other commitments:*
- (a) *any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and*
 - (b) *its share of the capital commitments of the joint ventures themselves.*
47. *A venturer should disclose a listing and description of interests in significant joint ventures and the proportion of ownership interest held in jointly controlled entities. A venturer which reports its interests in jointly controlled entities using the line-by-line reporting format for proportionate consolidation or the equity method should disclose the aggregate amounts of each of current assets, long-term assets, current liabilities, long-term liabilities, income and expenses related to its interests in joint ventures.*
48. *A venturer which does not issue consolidated financial statements, because it does not have subsidiaries, should disclose the information required in paragraphs 45, 46 and 47.*
49. It is appropriate that a venturer which does not prepare consolidated financial statements because it does not have subsidiaries provides the same information about its interests in joint ventures as those venturers that issue consolidated financial statements.

EFFECTIVE DATE

50. *Except for paragraphs 39, 40 and 41, this International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1992.*
51. *Paragraphs 39, 40 and 41 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.*
52. Paragraphs 39 and 40 of this Standard were approved in July 1998 to supersede paragraphs 39 and 40 of IAS 31, financial reporting of interests in joint ventures, reformatted in 1994. Paragraph 41 of this Standard was added in July 1998 between paragraphs 40 and 41 of IAS 31 reformatted in 1994.

INTERNATIONAL ACCOUNTING STANDARD IAS 33**Earnings per share**

This International Accounting Standard was approved by the IASC Board in January 1997 and became effective for financial statements covering periods beginning on or after 1 January 1998.

In 1999, paragraph 45 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 interpretation relates to IAS 33:

- SIC-24: earnings per share — financial instruments and other contracts that may be settled in shares.

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

OBJECTIVE

The objective of this Standard is to prescribe principles for the determination and presentation of earnings per share which will improve performance comparisons among different enterprises in the same period and among different accounting periods for the same enterprise. The focus of this Standard is on the denominator of the earnings per share calculation. Even though earnings per share data has limitations because of different accounting policies used for determining 'earnings', a consistently determined denominator enhances financial reporting.

SCOPE

Enterprises whose shares are publicly traded

1. ***This Standard should be applied by enterprises whose ordinary shares or potential ordinary shares are publicly traded and by enterprises that are in the process of issuing ordinary shares or potential ordinary shares in public securities markets.***

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2. ***When both parent and consolidated financial statements are presented, the information called for by this Standard need be presented only on the basis of consolidated information.***
3. Users of the financial statements of a parent are usually concerned with, and need to be informed about, the results of operations of the group as a whole.

Enterprises whose shares are not publicly traded

4. ***An enterprise which has neither ordinary shares nor potential ordinary shares which are publicly traded, but which discloses earnings per share, should calculate and disclose earnings per share in accordance with this Standard.***
5. An enterprise which has neither ordinary shares nor potential ordinary shares which are publicly traded is not required to disclose earnings per share. However, comparability in financial reporting among enterprises is maintained if any such enterprise that chooses to disclose earnings per share calculates earnings per share in accordance with the principles in this Standard.

DEFINITIONS

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

An ordinary share is an equity instrument that is subordinate to all other classes of equity instruments.

A potential ordinary share is a financial instrument or other contract that may entitle its holder to ordinary shares.

Warrants or options are financial instruments that give the holder the right to purchase ordinary shares.

7. Ordinary shares participate in the net profit for the period only after other types of shares such as preference shares. An enterprise may have more than one class of ordinary shares. Ordinary shares of the same class will have the same rights to receive dividends.
8. Examples of potential ordinary shares are:
 - (a) debt or equity instruments, including preference shares, that are convertible into ordinary shares;
 - (b) share warrants and options;
 - (c) employee plans that allow employees to receive ordinary shares as part of their remuneration and other share purchase plans; and
 - (d) shares which would be issued upon the satisfaction of certain conditions resulting from contractual arrangements, such as the purchase of a business or other assets.
9. ***The following terms are used with the meanings specified in IAS 32, financial instruments: disclosure and presentation:***

A financial instrument is any contract that gives rise to both a financial asset of one enterprise and a financial liability or equity instrument of another enterprise.

An equity instrument is any contract that evidences a residual interest in the assets of an enterprise after deducting all of its liabilities.

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.

MEASUREMENT

Basic earnings per share

10. ***Basic earnings per share should be calculated by dividing the net profit or loss for the period attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period.***

Earnings — basic

11. ***For the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to ordinary shareholders should be the net profit or loss for the period after deducting preference dividends.***
12. All items of income and expense which are recognised in a period, including tax expense, extraordinary items and minority interests, are included in the determination of the net profit or loss for the period (see IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies). The amount of net profit attributable to preference shareholders, including preference dividends for the period, is deducted from the net profit for the period (or added to the net loss for the period) in order to calculate the net profit or loss for the period attributable to ordinary shareholders.
13. The amount of preference dividends that is deducted from the net profit for the period is:
- the amount of any preference dividends on non-cumulative preference shares declared in respect of the period; and
 - the full amount of the required preference dividends for cumulative preference shares for the period, whether or not the dividends have been declared. The amount of preference dividends for the period does not include the amount of any preference dividends for cumulative preference shares paid or declared during the current period in respect of previous periods.

Per share — basic

14. ***For the purpose of calculating basic earnings per share, the number of ordinary shares should be the weighted average number of ordinary shares outstanding during the period.***
15. The weighted average number of ordinary shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or lesser number of shares being outstanding at any time. It is the number of ordinary shares outstanding at the beginning of the period, adjusted by the number of ordinary shares bought back or issued during the period multiplied by a time-weighting factor. The time-weighting factor is the number of days that the specific shares are outstanding as a proportion of the total number of days in the period; a reasonable approximation of the weighted average is adequate in many circumstances.

Example: weighted average number of shares

		Shares issued	Treasury shares	Shares outstanding
1 January 20X1	Balance at beginning of year	2 000	300	1 700
31 May 20X1	Issue of new shares for cash	800	—	2 500
1 December 20X1	Purchase of treasury shares for cash	—	250	2 250
31 December 20X1	Balance at end of year	2 800	550	2 250

Computation of weighted average:
 $(1\,700 \times 5/12) + (2\,500 \times 6/12) + (2\,250 \times 1/12) = 2\,146$ shares or:
 $(1\,700 \times 12/12) + (800 \times 7/12) - (250 \times 1/12) = 2\,146$ shares

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16. In most cases, shares are included in the weighted average number of shares from the date consideration is receivable (which is generally the date of their issue), for example:
- (a) ordinary shares issued in exchange for cash are included when cash is receivable;
 - (b) ordinary shares issued on the voluntary reinvestment of dividends on ordinary or preference shares are included at the dividend payment date;
 - (c) ordinary shares issued as a result of the conversion of a debt instrument to ordinary shares are included as of the date interest ceases accruing;
 - (d) ordinary shares issued in place of interest or principal on other financial instruments are included as of the date interest ceases accruing;
 - (e) ordinary shares issued in exchange for the settlement of a liability of the enterprise are included as of the settlement date;
 - (f) ordinary shares issued as consideration for the acquisition of an asset other than cash are included as of the date on which the acquisition is recognised; and
 - (g) ordinary shares issued for the rendering of services to the enterprise are included as the services are rendered.

In these and other cases the timing of the inclusion of ordinary shares is determined by the specific terms and conditions attaching to their issue. Due consideration should be given to the substance of any contract associated with the issue.

17. Ordinary shares issued as part of the purchase consideration of a business combination which is an acquisition are included in the weighted average number of shares as of the date of the acquisition because the acquirer incorporates the results of the operations of the acquiree into its income statement as from the date of acquisition. Ordinary shares issued as part of a business combination which is a uniting of interests are included in the calculation of the weighted average number of shares for all periods presented because the financial statements of the combined enterprise are prepared as if the combined entity had always existed. Therefore, the number of ordinary shares used for the calculation of basic earnings per share in a business combination which is a uniting of interests is the aggregate of the weighted average number of shares of the combined enterprises, adjusted to equivalent shares of the enterprise whose shares are outstanding after the combination.
18. Where ordinary shares are issued in partly paid form, these partly paid shares are treated as a fraction of an ordinary share to the extent that they were entitled to participate in dividends relative to a fully paid ordinary share during the financial period.
19. Ordinary shares which are issuable upon the satisfaction of certain conditions (contingently issuable shares) are considered outstanding, and included in the computation of basic earnings per share from the date when all necessary conditions have been satisfied. Outstanding ordinary shares that are contingently returnable (that is subject to recall) are treated as contingently issuable shares.
20. ***The weighted average number of ordinary shares outstanding during the period and for all periods presented should be adjusted for events, other than the conversion of potential ordinary shares, that have changed the number of ordinary shares outstanding, without a corresponding change in resources.***
21. Ordinary shares may be issued, or the number of shares outstanding may be reduced, without a corresponding change in resources. Examples include:
- (a) a capitalisation or bonus issue (known in some countries as a stock dividend);

- (b) a bonus element in any other issue, for example a bonus element in a rights issue to existing shareholders;
- (c) a share split; and
- (d) a reverse share split (consolidation of shares).
22. In a capitalisation or bonus issue or a share split, ordinary shares are issued to existing shareholders for no additional consideration. Therefore, the number of ordinary shares outstanding is increased without an increase in resources. The number of ordinary shares outstanding before the event is adjusted for the proportionate change in the number of ordinary shares outstanding as if the event had occurred at the beginning of the earliest period reported. For example, on a two-for-one bonus issue, the number of shares outstanding prior to the issue is multiplied by a factor of three to obtain the new total number of shares, or by a factor of two to obtain the number of additional shares.
23. With reference to 21(b), the issue of ordinary shares at the time of exercise or conversion of potential ordinary shares will not usually give rise to a bonus element, since the potential ordinary shares will usually have been issued for full value, resulting in a proportionate change in the resources available to the enterprise. In a rights issue, the exercise price is often less than the fair value of the shares. Therefore such a rights issue includes a bonus element. The number of ordinary shares to be used in calculating basic earnings per share for all periods prior to the rights issue is the number of ordinary shares outstanding prior to the issue, multiplied by the following factor:

Fair value per share immediately prior to the exercise of rights

Theoretical ex-rights fair value per share

The theoretical ex-rights fair value per share is calculated by adding the aggregate fair value of the shares immediately prior to the exercise of the rights to the proceeds from the exercise of the rights, and dividing by the number of shares outstanding after the exercise of the rights. Where the rights themselves are to be publicly traded separately from the shares prior to the exercise date, fair value for the purposes of this calculation is established at the close of the last day on which the shares are traded together with the rights.

Example — bonus issue

Net profit 20X0	180
Net profit 20X1	600
Ordinary shares outstanding until 30 September 20X1	200
Bonus issue 1 October 20X1	Two ordinary shares for each ordinary share outstanding at 30 September 20X1 $200 \times 2 = 400$
Earnings per share 20X1	$\frac{600}{(200 + 400)} = 1,00$
Adjusted earnings per share 20X0	$\frac{180}{(200 + 400)} = 0,30$

Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of 20X0, the earliest period reported.

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Example — rights issue

Net profit	20X0:1 100; 20X1:1 500; 20X2:1 800
Shares outstanding prior to rights issue	500 shares
Rights issue	One new share for each five outstanding (100 new shares total)
	Exercise price: 5,00
	Last date to exercise rights: 1 March 20X1
Fair value of one ordinary share immediately prior to exercise on 1 March 20X1	11,00

Computation of theoretical ex-rights value per share

$$\frac{\text{Fair value of all outstanding shares} + \text{total amount received from exercise of rights}}{\text{Number of shares outstanding prior to exercise} + \text{number of shares issued in the exercise}}$$

$$\frac{(11,00 \times 500 \text{ shares}) + (5,00 \times 100 \text{ shares})}{(500 \text{ shares} + 100 \text{ shares})}$$

Theoretical ex-rights value per share = 10,00

Computation of adjustment factor

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}} = \frac{11,00}{10,00} = 1,1$$

Computation of earnings per share

	<u>20X0</u>	<u>20X1</u>	<u>20X2</u>
20X0 EPS as originally reported: 1 100/500 shares	2,20		
20X0 EPS restated for rights issue: 1 100/(500 shares x 1,1)	2,00		
20X1 EPS including effects of rights issue		2,54	
	<u>1 500</u>		
	(500 × 1,1 × 2/12) + (600 × 10/12)		
20X2 EPS 1 800/600 shares			3,00

Diluted earnings per share

24. **For the purpose of calculating diluted earnings per share, the net profit attributable to ordinary shareholders and the weighted average number of shares outstanding should be adjusted for the effects of all dilutive potential ordinary shares⁽¹⁾.**
25. The calculation of diluted earnings per share is consistent with the calculation of basic earnings per share while giving effect to all dilutive potential ordinary shares that were outstanding during the period, that is:
- (a) the net profit for the period attributable to ordinary shares is increased by the after-tax amount of dividends and interest recognised in the period in respect of the dilutive potential ordinary shares and adjusted for any other changes in income or expense that would result from the conversion of the dilutive potential ordinary shares.

⁽¹⁾ See also, SIC-24: earnings per share — financial instruments and other contracts that may be settled in shares.

- (b) the weighted average number of ordinary shares outstanding is increased by the weighted average number of additional ordinary shares which would have been outstanding assuming the conversion of all dilutive potential ordinary shares.

Earnings — diluted

26. ***For the purpose of calculating diluted earnings per share, the amount of net profit or loss for the period attributable to ordinary shareholders, as calculated in accordance with paragraph 11, should be adjusted by the after-tax effect:***
- (a) ***any dividends on dilutive potential ordinary shares which have been deducted in arriving at the net profit attributable to ordinary shareholders as calculated in accordance with paragraph 11;***
- (b) ***interest recognised in the period for the dilutive potential ordinary shares; and***
- (c) ***any other changes in income or expense that would result from the conversion of the dilutive potential ordinary shares.***
27. After the potential ordinary shares are converted into ordinary shares, the dividends, interest and other income or expense associated with those potential ordinary shares will no longer be incurred. Instead, the new ordinary shares will be entitled to participate in the net profit attributable to ordinary shareholders. Therefore, the net profit for the period attributable to ordinary shareholders calculated in accordance with paragraph 11 is increased by the amount of dividends, interest and other income or expense that will be saved on the conversion of the dilutive potential ordinary shares into ordinary shares. The expenses associated with potential ordinary shares include fees and discount or premium that are accounted for as yield adjustments (see IAS 32). The amounts of dividends, interest and other income or expense are adjusted for any taxes, borne by the enterprise, that are attributable to them.

Example — convertible bonds

Net profit	1 004
Ordinary shares outstanding	1 000
Basic earnings per share	1,0
Convertible bonds	100
Each block of 10 bonds is convertible into three ordinary shares	
Interest expense for the current year relating to the liability component of the convertible bond	10
Current and deferred tax relating to that interest expense	4

Note: the interest expense includes amortisation of the discount arising on initial recognition of the liability component (see IAS 32).

Adjusted net profit	$1\ 004 + 10 - 4 = 1\ 010$
Number of ordinary shares resulting from conversion of bond	30
Number of ordinary shares used to compute diluted earnings per share	$1\ 000 + 30 = 1\ 030$
Diluted earnings per share	$\frac{1\ 000}{1\ 030} = 0,98$

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28. The conversion of some potential ordinary shares may lead to consequential changes in other income or expenses. For example, the reduction of interest expense related to potential ordinary shares and the resulting increase in net profit for the period may lead to an increase in the expense relating to a non-discretionary employee profit sharing plan. For the purpose of calculating diluted earnings per share, the net profit or loss for the period is adjusted for any such consequential changes in income or expense.

Per share — diluted

29. ***For the purpose of calculating diluted earnings per share, the number of ordinary shares should be the weighted average number of ordinary shares calculated in accordance with paragraphs 14 and 20, plus the weighted average number of ordinary shares which would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares. Dilutive potential ordinary shares should be deemed to have been converted into ordinary shares at the beginning of the period or, if later, the date of the issue of the potential ordinary shares.***
30. The number of ordinary shares which would be issued on the conversion of dilutive potential ordinary shares is determined from the terms of the potential ordinary shares. The computation assumes the most advantageous conversion rate or exercise price from the standpoint of the holder of the potential ordinary shares.
31. As in the computation of basic earnings per share, ordinary shares whose issue is contingent upon the occurrence of certain events shall be considered outstanding and included in the computation of diluted earnings per share if the conditions have been met (the events occurred). Contingently issuable shares should be included as of the beginning of the period (or as of the date of the contingent share agreement, if later). If the conditions have not been met, the number of contingently issuable shares included in the diluted earnings per share computation is based on the number of shares that would be issuable if the end of the reporting period was the end of the contingency period. Restatement is not permitted if the conditions are not met when the contingency period expires. The provisions of this paragraph apply equally to potential ordinary shares that are issuable upon the satisfaction of certain conditions (contingently issuable potential ordinary shares).
32. A subsidiary, joint venture or associate may issue potential ordinary shares which are convertible into either ordinary shares of the subsidiary, joint venture or associate, or ordinary shares of the reporting enterprise. If these potential ordinary shares of the subsidiary, associate or joint venture have a dilutive effect on the consolidated basic earnings per share of the reporting enterprise, they are included in the calculation of diluted earnings per share.
33. ***For the purpose of calculating diluted earnings per share, an enterprise should assume the exercise of dilutive options and other dilutive potential ordinary shares of the enterprise. The assumed proceeds from these issues should be considered to have been received from the issue of shares at fair value. The difference between the number of shares issued and the number of shares that would have been issued at fair value should be treated as an issue of ordinary shares for no consideration.***
34. Fair value for this purpose is calculated on the basis of the average price of the ordinary shares during the period.
35. Options and other share purchase arrangements are dilutive when they would result in the issue of ordinary shares for less than fair value. The amount of the dilution is fair value less the issue price. Therefore, in order to calculate diluted earnings per share, each such arrangement is treated as consisting of:
- (a) a contract to issue a certain number of ordinary shares at their average fair value during the period. The shares so to be issued are fairly priced and are assumed to be neither dilutive nor anti-dilutive. They are ignored in the computation of diluted earnings per share; and

- (b) a contract to issue the remaining ordinary shares for no consideration. Such ordinary shares generate no proceeds and have no effect on the net profit attributable to ordinary shares outstanding. Therefore such shares are dilutive and they are added to the number of ordinary shares outstanding in the computation of diluted earnings per share.

Example — effects of share options on diluted earnings per share

Net profit for year 20X1	1 200 000		
Weighted average number of ordinary shares outstanding during year 20X1	500 000 shares		
Average fair value of one ordinary share during year 20X1	20,00		
Weighted average number of shares under option during year 20X1	100 000 shares		
Exercise price for shares under option during year 20X1	15,00		
Computation of earnings per share			
	per share	earnings	shares
Net profit for year 20X1		1 200 000	
Weighted average shares outstanding during year 20X1			500 000
Basic earnings per share	2,40		
Number of shares under option			100 000
Number of shares that would have been issued at fair value: (100 000 × 15,00)/20,00		(*)	(75 000)
Diluted earnings per share	2,29	1 200 000	525 000

(*) The earnings have not been increased as the total number of shares has been increased only by the number of shares (25 000) deemed for the purpose of the computation to have been issued for no consideration (see 35(b) above).

36. This method of calculating the effect of options and other share purchase arrangements produces the same result as the treasury stock method which is used in some countries. This does not imply that the enterprise has entered into a transaction to purchase its own shares, which may not be practicable in certain circumstances or legal in some jurisdictions.
37. To the extent that partly paid shares are not entitled to participate in dividends during the financial period they are considered the equivalent of warrants or options.

Dilutive potential ordinary shares

38. **Potential ordinary shares should be treated as dilutive when, and only when, their conversion to ordinary shares would decrease net profit per share from continuing ordinary operations.**
39. An enterprise uses net profit from continuing ordinary activities as 'the control number' that is used to establish whether potential ordinary shares are dilutive or anti-dilutive. The net profit from continuing ordinary activities is the net profit from ordinary activities (as defined in IAS 8) after deducting preference dividends and after excluding items relating to discontinued operations; therefore, it excludes extraordinary items and the effects of changes in accounting policies and of corrections of fundamental errors.

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40. Potential ordinary shares are anti-dilutive when their conversion to ordinary shares would increase earnings per share from continuing ordinary operations or decrease loss per share from continuing ordinary operations. The effects of anti-dilutive potential ordinary shares are ignored in calculating diluted earnings per share.
41. In considering whether potential ordinary shares are dilutive or anti-dilutive, each issue or series of potential ordinary shares is considered separately rather than in aggregate. The sequence in which potential ordinary shares are considered may affect whether or not they are dilutive. Therefore, in order to maximise the dilution of basic earnings per share, each issue or series of potential ordinary shares is considered in sequence from the most dilutive to the least dilutive.

Example — determining the order in which to include dilutive securities in the calculation of weighted average Number of Shares

Earnings — net profit attributable to ordinary shareholders	10 000 000
Ordinary shares outstanding	2 000 000
Average fair value of one ordinary share during year	75,00
Potential ordinary shares	
Options	100 000 with exercise price of 60
Convertible preference shares	800 000 shares entitled to a cumulative dividend of 8 per share. Each preference share is convertible to two ordinary shares
5 % convertible bond	Nominal amount 100 000 000. Each 1 000 bond is convertible to 20 ordinary shares. There is no amortisation of premium or discount affecting the determination of interest expense
Tax rate	40 %

Increase in earnings attributable to ordinary shareholders on conversion of potential ordinary shares

	Increase in earnings	Increase in number of ordinary shares	Earnings per incremental share
Options			
Increase in earnings	nil		
Incremental shares issued for no consideration $100\,000 \times (75 - 60) / 75$		20 000	nil
Convertible preference shares			
Increase in net profit $8 \times 800\,000$	6 400 000		
Incremental shares $2 \times 800\,000$		1 600 000	4,00
5 % convertible bonds			
Increase in net profit $100\,000\,000 \times 0,05 \times (1 - 0,4)$	3 000 000		
Incremental shares $100\,000 \times 20$		2 000 000	1,50

Computation of diluted earnings per share

	Net profit attributable	Ordinary shares	Per share
As reported options	10 000 000	2 000 000	5,00
		20 000	
	10 000 000	2 020 000	4,95 dilutive
5 % convertible bonds	3 000 000	2 000 000	
	13 000 000	4 020 000	3,23 dilutive
Convertible preference shares	6 400 000	1 600 000	
	19 400 000	5 620 000	3,45 anti-dilutive

Since diluted earnings per share are increased when taking the convertible preference shares into account (from 3,23 to 3,45), the convertible preference shares are anti-dilutive and are ignored in the calculation of diluted earnings per share. Therefore, diluted earnings per share are 3,23.

This example does not illustrate the classification of convertible financial instruments between liabilities and equity or the classification of related interest and dividends between expenses and equity as required by IAS 32.

42. Potential ordinary shares are weighted for the period they were outstanding. Potential ordinary shares that were cancelled or allowed to lapse during the reporting period are included in the computation of diluted earnings per share only for the portion of the period during which they were outstanding. Potential ordinary shares that have been converted into ordinary shares during the reporting period are included in the calculation of diluted earnings per share from the beginning of the period to the date of conversion; from the date of conversion, the resulting ordinary shares are included in both basic and diluted earnings per share.

RESTATEMENT

43. *If the number of ordinary or potential ordinary shares outstanding increases as a result of a capitalisation or bonus issue or share split or decreases as a result of a reverse share split, the calculation of basic and diluted earnings per share for all periods presented should be adjusted retrospectively. If these changes occur after the balance sheet date but before issue of the financial statements, the per share calculations for those and any prior period financial statements presented should be based on the new number of shares. When per share calculations reflect such changes in the number of shares, that fact should be disclosed. In addition, basic and diluted earnings per share of all periods presented should be adjusted for:*

(a) *the effects of fundamental errors, and adjustments resulting from changes in accounting policies, dealt with in accordance with the benchmark treatment in IAS 8; and*

(b) *the effects of a business combination which is a uniting of interests.*

44. An enterprise does not restate diluted earnings per share of any prior period presented for changes in the assumptions used or for the conversion of potential ordinary shares into ordinary shares outstanding.

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45. An enterprise is encouraged to disclose a description of ordinary share transactions or potential ordinary share transactions, other than capitalisation issues and share splits, which occur after the balance sheet date when 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). Examples of such transactions include:
- (a) the issue of shares for cash;
 - (b) the issue of shares when the proceeds are used to repay debt or preference shares outstanding at the balance sheet date;
 - (c) the redemption of ordinary shares outstanding;
 - (d) the conversion or exercise of potential ordinary shares, outstanding at the balance sheet date, into ordinary shares;
 - (e) the issue of warrants, options or convertible securities; and
 - (f) the achievement of conditions that would result in the issue of contingently issuable shares.
46. Earnings per share amounts are not adjusted for such transactions occurring after the balance sheet date because such transactions do not affect the amount of capital used to produce the net profit or loss for the period.

PRESENTATION

47. *An enterprise should present basic and diluted earnings per share on the face of the income statement for each class of ordinary shares that has a different right to share in the net profit for the period. An enterprise should present basic and diluted earnings per share with equal prominence for all periods presented.*
48. *This Standard requires an enterprise to present basic and diluted earnings per share, even if the amounts disclosed are negative (a loss per share).*

DISCLOSURE

49. *An enterprise should disclose the following:*
- (a) *the amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net profit or loss for the period; and*
 - (b) *the weighted average number of ordinary shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other.*
50. Financial instruments and other contracts generating potential ordinary shares may incorporate terms and conditions which affect the measurement of basic and diluted earnings per share. These terms and conditions may determine whether or not any potential ordinary shares are dilutive and, if so, the effect on the weighted average number of shares outstanding and any consequent adjustments to the net profit attributable to ordinary shareholders. Whether or not the disclosure of the terms and conditions is required by IAS 32 such disclosure is encouraged by this Standard.
51. *If an enterprise discloses, in addition to basic and diluted earnings per share, per share amounts using a reported component of net profit other than net profit or loss for the period attributable to ordinary shareholders, such amounts should be calculated using the weighted average number of ordinary shares determined in accordance with this Standard. If a component of net profit is used which is not reported as a line item in the income statement, a reconciliation should be provided between the component used and a line item which is reported in the income statement. Basic and diluted per share amounts should be disclosed with equal prominence.*

52. An enterprise may wish to disclose more information than this Standard requires. Such information may help the users to evaluate the performance of the enterprise and may take the form of per share amounts for various components of net profit. Such disclosures are encouraged. However, when such amounts are disclosed, the denominators are calculated in accordance with this Standard in order to ensure the comparability of the per share amounts disclosed.

EFFECTIVE DATE

53. *This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1998. Earlier application is encouraged.*

INTERNATIONAL ACCOUNTING STANDARD IAS 34

Interim financial reporting

This International Accounting Standard was approved by the IASC Board in February 1998 and became effective for financial statements covering periods beginning on or after 1 January 1999.

In April 2000, Appendix C, paragraph 7, was amended by IAS 40, investment property.

INTRODUCTION

1. This Standard ('IAS 34') addresses interim financial reporting, a matter not covered in a prior International Accounting Standard. IAS 34 is effective for accounting periods beginning on or after 1 January 1999.
2. An interim financial report is a financial report that contains either a complete or condensed set of financial statements for a period shorter than an enterprise's full financial year.
3. This Standard does not mandate which enterprises should publish interim financial reports, how frequently, or how soon after the end of an interim period. In IASC's judgement, those matters should be decided by national governments, securities regulators, stock exchanges, and accountancy bodies. This Standard applies if a company is required or elects to publish an interim financial report in accordance with International Accounting Standards.
4. This Standard:
 - (a) defines the minimum content of an interim financial report, including disclosures; and
 - (b) identifies the accounting recognition and measurement principles that should be applied in an interim financial report.
5. Minimum content of an interim financial report is a condensed balance sheet, condensed income statement, condensed cash flow statement, condensed statement showing changes in equity, and selected explanatory notes.
6. On the presumption that anyone who reads an enterprise's interim report will also have access to its most recent annual report, virtually none of the notes to the annual financial statements are repeated or updated in the interim report. Instead, the interim notes include primarily an explanation of the events and changes that are significant to an understanding of the changes in financial position and performance of the enterprise since the last annual reporting date.
7. An enterprise should apply the same accounting policies in its interim financial report as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. The frequency of an enterprise's reporting — annual, half-yearly, or quarterly — should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes are made on a year-to-date basis.

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8. An appendix to this Standard provides guidance for applying the basic recognition and measurement principles at interim dates to various types of asset, liability, income, and expense. Income tax expense for an interim period is based on an estimated average annual effective income tax rate, consistent with the annual assessment of taxes.
9. In deciding how to recognise, classify, or disclose an item for interim financial reporting purposes, materiality is to be assessed in relation to the interim period financial data, not forecasted annual data.

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

OBJECTIVE

The objective of this Standard is to prescribe the minimum content of an interim financial report and to prescribe the principles for recognition and measurement in complete or condensed financial statements for an interim period. Timely and reliable interim financial reporting improves the ability of investors, creditors, and others to understand an enterprise's capacity to generate earnings and cash flows and its financial condition and liquidity.

SCOPE

1. This Standard does not mandate which enterprises should be required to publish interim financial reports, how frequently, or how soon after the end of an interim period. However, governments, securities regulators, stock exchanges, and accountancy bodies often require enterprises whose debt or equity securities are publicly traded to publish interim financial reports. This Standard applies if an enterprise is required or elects to publish an interim financial report in accordance with International Accounting Standards. The International Accounting Standards Committee encourages publicly traded enterprises to provide interim financial reports that conform to the recognition, measurement, and disclosure principles set out in this Standard. Specifically, publicly traded enterprises are encouraged:
 - (a) to provide interim financial reports at least as of the end of the first half of their financial year; and
 - (b) to make their interim financial reports available not later than 60 days after the end of the interim period.
2. Each financial report, annual or interim, is evaluated on its own for conformity to International Accounting Standards. The fact that an enterprise may not have provided interim financial reports during a particular financial year or may have provided interim financial reports that do not comply with this Standard does not prevent the enterprise's annual financial statements from conforming to International Accounting Standards if they otherwise do so.
3. If an enterprise's interim financial report is described as complying with International Accounting Standards, it must comply with all of the requirements of this Standard. Paragraph 19 requires certain disclosures in that regard.

DEFINITIONS

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

Interim period is a financial reporting period shorter than a full financial year.

Interim financial report means a financial report containing either a complete set of financial statements (as described in IAS 1, presentation of financial statements) or a set of condensed financial statements (as described in this Standard) for an interim period.

CONTENT OF AN INTERIM FINANCIAL REPORT

5. IAS 1 defines a complete set of financial statements as including the following components:
 - (a) balance sheet;
 - (b) income statement;
 - (c) statement showing either (i) all changes in equity or (ii) changes in equity other than those arising from capital transactions with owners and distributions to owners;
 - (d) cash flow statement; and
 - (e) accounting policies and explanatory notes.

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6. In the interest of timeliness and cost considerations and to avoid repetition of information previously reported, an enterprise may be required to or may elect to provide less information at interim dates as compared with its annual financial statements. This Standard defines the minimum content of an interim financial report as including condensed financial statements and selected explanatory notes. The interim financial report is intended to provide an update on the latest complete set of annual financial statements. Accordingly, it focuses on new activities, events, and circumstances and does not duplicate information previously reported.
7. Nothing in this Standard is intended to prohibit or discourage an enterprise from publishing a complete set of financial statements (as described in IAS 1) in its interim financial report, rather than condensed financial statements and selected explanatory notes. Nor does this Standard prohibit or discourage an enterprise from including in condensed interim financial statements more than the minimum line items or selected explanatory notes as set out in this Standard. The recognition and measurement guidance in this Standard applies also to complete financial statements for an interim period, and such statements would include all of the disclosures required by this Standard (particularly the selected note disclosures in paragraph 16) as well as those required by other International Accounting Standards.

Minimum components of an interim financial report

8. **An interim financial report should include, at a minimum, the following components:**
 - (a) **condensed balance sheet;**
 - (b) **condensed income statement;**
 - (c) **condensed statement showing either (i) all changes in equity or (ii) changes in equity other than those arising from capital transactions with owners and distributions to owners;**
 - (d) **condensed cash flow statement; and**
 - (e) **selected explanatory notes.**

Form and content of interim financial statements

9. **If an enterprise publishes a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements of IAS 1 for a complete set of financial statements.**
10. **If an enterprise publishes a set of condensed financial statements in its interim financial report, those condensed statements should include, at a minimum, each of the headings and subtotals that were included in its most recent annual financial statements and the selected explanatory notes as required by this Standard. Additional line items or notes should be included if their omission would make the condensed interim financial statements misleading.**
11. **Basic and diluted earnings per share should be presented on the face of an income statement, complete or condensed, for an interim period.**
12. IAS 1 provides guidance on the structure of financial statements and includes an appendix, 'Illustrative financial statement structure', that provides further guidance on major headings and subtotals.
13. While IAS 1 requires that a statement showing changes in equity be presented as a separate component of an enterprise's financial statements, it permits information about changes in equity arising from capital transactions with owners and distributions to owners to be shown either on the face of the statement or, alternatively, in the notes. An enterprise follows the same format in its interim statement showing changes in equity as it did in its most recent annual statement.
14. An interim financial report is prepared on a consolidated basis if the enterprise's most recent annual financial statements were consolidated statements. The parent's separate financial statements are not consistent or comparable with the consolidated statements in the most recent annual financial report. If an enterprise's annual financial report included the parent's separate financial statements in addition to consolidated financial statements, this Standard neither requires nor prohibits the inclusion of the parent's separate statements in the enterprise's interim financial report.

Selected explanatory notes

15. A user of an enterprise's interim financial report will also have access to the most recent annual financial report of that enterprise. It is unnecessary, therefore, for the notes to an interim financial report to provide relatively insignificant updates to the information that was already reported in the notes in the most recent annual report. At an interim date, an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the enterprise since the last annual reporting date is more useful.
16. ***An enterprise should include the following information, as a minimum, in the notes to its interim financial statements, if material and if not disclosed elsewhere in the interim financial report. The information should normally be reported on a financial year-to-date basis. However, the enterprise should also disclose any events or transactions that are material to an understanding of the current interim period:***
- (a) *a statement that the same accounting policies and methods of computation are followed in the interim financial statements as compared with the most recent annual financial statements or, if those policies or methods have been changed, a description of the nature and effect of the change;*
 - (b) *explanatory comments about the seasonality or cyclical nature of interim operations;*
 - (c) *the nature and amount of items affecting assets, liabilities, equity, net income, or cash flows that are unusual because of their nature, size, or incidence;*
 - (d) *the nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amounts reported in prior financial years, if those changes have a material effect in the current interim period;*
 - (e) *issuances, repurchases, and repayments of debt and equity securities;*
 - (f) *dividends paid (aggregate or per share) separately for ordinary shares and other shares;*
 - (g) *segment revenue and segment result for business segments or geographical segments, whichever is the enterprise's primary basis of segment reporting (disclosure of segment data is required in an enterprise's interim financial report only if IAS 14, segment reporting, requires that enterprise to disclose segment data in its annual financial statements);*
 - (h) *material events subsequent to the end of the interim period that have not been reflected in the financial statements for the interim period;*
 - (i) *the effect of changes in the composition of the enterprise during the interim period, including business combinations, acquisition or disposal of subsidiaries and long-term investments, restructurings, and discontinuing operations; and*
 - (j) *changes in contingent liabilities or contingent assets since the last annual balance sheet date.*
17. Examples of the kinds of disclosures that are required by paragraph 16 are set out below. Individual International Accounting Standards provide guidance regarding disclosures for many of these items:
- (a) the write-down of inventories to net realisable value and the reversal of such a write-down;
 - (b) recognition of a loss from the impairment of property, plant, and equipment, intangible assets, or other assets, and the reversal of such an impairment loss;
 - (c) the reversal of any provisions for the costs of restructuring;

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- (d) acquisitions and disposals of items of property, plant, and equipment;
 - (e) commitments for the purchase of property, plant, and equipment;
 - (f) litigation settlements;
 - (g) corrections of fundamental errors in previously reported financial data;
 - (h) extraordinary items;
 - (i) any debt default or any breach of a debt covenant that has not been corrected subsequently; and
 - (j) related party transactions.
18. Other International Accounting Standards specify disclosures that should be made in financial statements. In that context, financial statements means complete sets of financial statements of the type normally included in an annual financial report and sometimes included in other reports. The disclosures required by those other International Accounting Standards are not required if an enterprise's interim financial report includes only condensed financial statements and selected explanatory notes rather than a complete set of financial statements.

Disclosure of compliance with IAS

19. ***If an enterprise's interim financial report is in compliance with this International Accounting Standard, that fact should be disclosed. An interim financial report should not be described as complying with International Accounting Standards unless it complies with all of the requirements of each applicable Standard and each applicable interpretation of the Standing Interpretations Committee.***

Periods for which interim financial statements are required to be presented

20. ***Interim reports should include interim financial statements (condensed or complete) for periods as follows:***
- (a) ***balance sheet as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year;***
 - (b) ***income statements for the current interim period and cumulatively for the current financial year to date, with comparative income statements for the comparable interim periods (current and year-to-date) of the immediately preceding financial year;***
 - (c) ***statement showing changes in equity cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year; and***
 - (d) ***cash flow statement cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.***
21. For an enterprise whose business is highly seasonal, financial information for the 12 months ending on the interim reporting date and comparative information for the prior 12-month period may be useful. Accordingly, enterprises whose business is highly seasonal are encouraged to consider reporting such information in addition to the information called for in the preceding paragraph.
22. Appendix A illustrates the periods required to be presented by an enterprise that reports half-yearly and an enterprise that reports quarterly.

Materiality

23. ***In deciding how to recognise, measure, classify, or disclose an item for interim financial reporting purposes, materiality should be assessed in relation to the interim period financial data. In making assessments of materiality, it should be recognised that interim measurements may rely on estimates to a greater extent than measurements of annual financial data.***
24. The 'Preface to International Accounting Standards' states that 'International Accounting Standards are not intended to apply to immaterial items.' The framework states that 'information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements'. IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies, requires separate disclosure of material extraordinary items, unusual ordinary items, discontinued operations, changes in accounting estimates, fundamental errors, and changes in accounting policies. IAS 8 does not contain quantified guidance as to materiality.
25. While judgement is always required in assessing materiality for financial reporting purposes, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for example, unusual or extraordinary items, changes in accounting policies or estimates, and fundamental errors are recognised and disclosed based on materiality in relation to interim period data to avoid misleading inferences that might result from nondisclosure. The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an enterprise's financial position and performance during the interim period.

DISCLOSURE IN ANNUAL FINANCIAL STATEMENTS

26. ***If an estimate of an amount reported in an interim period is changed significantly during the final interim period of the financial year but a separate financial report is not published for that final interim period, the nature and amount of that change in estimate should be disclosed in a note to the annual financial statements for that financial year.***
27. IAS 8 requires disclosure of the nature and (if practicable) the amount of a change in estimate that either has a material effect in the current period or is expected to have a material effect in subsequent periods. Paragraph 16(d) of this Standard requires similar disclosure in an interim financial report. Examples include changes in estimate in the final interim period relating to inventory write-downs, restructurings, or impairment losses that were reported in an earlier interim period of the financial year. The disclosure required by the preceding paragraph is consistent with the IAS 8 requirement and is intended to be narrow in scope — relating only to the change in estimate. An enterprise is not required to include additional interim period financial information in its annual financial statements.

RECOGNITION AND MEASUREMENT

Same accounting policies as annual

28. ***An enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. However, the frequency of an enterprise's reporting (annual, half-yearly, or quarterly) should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes should be made on a year-to-date basis.***

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29. Requiring that an enterprise apply the same accounting policies in its interim financial statements as in its annual statements may seem to suggest that interim period measurements are made as if each interim period stands alone as an independent reporting period. However, by providing that the frequency of an enterprise's reporting should not affect the measurement of its annual results, paragraph 28 acknowledges that an interim period is a part of a larger financial year. Year-to-date measurements may involve changes in estimates of amounts reported in prior interim periods of the current financial year. But the principles for recognising assets, liabilities, income, and expenses for interim periods are the same as in annual financial statements.
30. To illustrate:
- (a) the principles for recognising and measuring losses from inventory write-downs, restructurings, or impairments in an interim period are the same as those that an enterprise would follow if it prepared only annual financial statements. However, if such items are recognised and measured in one interim period and the estimate changes in a subsequent interim period of that financial year, the original estimate is changed in the subsequent interim period either by accrual of an additional amount of loss or by reversal of the previously recognised amount;
 - (b) a cost that does not meet the definition of an asset at the end of an interim period is not deferred on the balance sheet either to await future information as to whether it has met the definition of an asset or to smooth earnings over interim periods within a financial year; and
 - (c) income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year. Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual income tax rate changes.
31. Under the framework for the preparation and presentation of financial statements (the framework), recognition is the 'process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition'. The definitions of assets, liabilities, income, and expenses are fundamental to recognition, both at annual and interim financial reporting dates.
32. For assets, the same tests of future economic benefits apply at interim dates and at the end of an enterprise's financial year. Costs that, by their nature, would not qualify as assets at financial year end would not qualify at interim dates either. Similarly, a liability at an interim reporting date must represent an existing obligation at that date, just as it must at an annual reporting date.
33. An essential characteristic of income (revenue) and expenses is that the related inflows and outflows of assets and liabilities have already taken place. If those inflows or outflows have taken place, the related revenue and expense are recognised; otherwise they are not recognised. The framework says that 'expenses are recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably ...'. [The] framework does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities'.
34. In measuring the assets, liabilities, income, expenses, and cash flows reported in its financial statements, an enterprise that reports only annually is able to take into account information that becomes available throughout the financial year. Its measurements are, in effect, on a year-to-date basis.
35. An enterprise that reports half-yearly uses information available by mid-year or shortly thereafter in making the measurements in its financial statements for the first six-month period and information available by year-end or shortly thereafter for the 12-month period. The 12-month measurements will reflect possible changes

in estimates of amounts reported for the first six-month period. The amounts reported in the interim financial report for the first six-month period are not retrospectively adjusted. Paragraphs 16(d) and 26 require, however, that the nature and amount of any significant changes in estimates be disclosed.

36. An enterprise that reports more frequently than half-yearly measures income and expenses on a year-to-date basis for each interim period using information available when each set of financial statements is being prepared. Amounts of income and expenses reported in the current interim period will reflect any changes in estimates of amounts reported in prior interim periods of the financial year. The amounts reported in prior interim periods are not retrospectively adjusted. Paragraphs 16(d) and 26 require, however, that the nature and amount of any significant changes in estimates be disclosed.

Revenues received seasonally, cyclically, or occasionally

37. **Revenues that are received seasonally, cyclically, or occasionally within a financial year should not be anticipated or deferred as of an interim date if anticipation or deferral would not be appropriate at the end of the enterprise's financial year.**
38. Examples include dividend revenue, royalties, and government grants. Additionally, some enterprises consistently earn more revenues in certain interim periods of a financial year than in other interim periods, for example, seasonal revenues of retailers. Such revenues are recognised when they occur.

Costs incurred unevenly during the financial year

39. **Costs that are incurred unevenly during an enterprise's financial year should be anticipated or deferred for interim reporting purposes if, and only if, it is also appropriate to anticipate or defer that type of cost at the end of the financial year.**

Applying the recognition and measurement principles

40. Appendix B provides examples of applying the general recognition and measurement principles set out in paragraphs 28 to 39.

Use of estimates

41. **The measurement procedures to be followed in an interim financial report should be designed to ensure that the resulting information is reliable and that all material financial information that is relevant to an understanding of the financial position or performance of the enterprise is appropriately disclosed. While measurements in both annual and interim financial reports are often based on reasonable estimates, the preparation of interim financial reports generally will require a greater use of estimation methods than annual financial reports.**
42. Appendix C provides examples of the use of estimates in interim periods.

RESTATEMENT OF PREVIOUSLY REPORTED INTERIM PERIODS

43. **A change in accounting policy, other than one for which the transition is specified by a new International Accounting Standard, should be reflected by:**
- (a) **restating the financial statements of prior interim periods of the current financial year and the comparable interim periods of prior financial years (see paragraph 20), if the enterprise follows the benchmark treatment under IAS 8; or**
- (b) **restating the financial statements of prior interim periods of the current financial year, if the enterprise follows the allowed alternative treatment under IAS 8. In this case, comparable interim periods of prior financial years are not restated.**

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44. One objective of the preceding principle is to ensure that a single accounting policy is applied to a particular class of transactions throughout an entire financial year. Under IAS 8, a change in accounting policy is reflected by retrospective application, with restatement of prior period financial data, if practicable. However, if the amount of the adjustment relating to prior financial years is not reasonably determinable, then under IAS 8 the new policy is applied prospectively. An allowed alternative is to include the entire cumulative retrospective adjustment in the determination of net profit or loss for the period in which the accounting policy is changed. The effect of the principle in paragraph 43 is to require that within the current financial year any change in accounting policy be applied retrospectively to the beginning of the financial year.
45. To allow accounting changes to be reflected as of an interim date within the financial year would allow two differing accounting policies to be applied to a particular class of transactions within a single financial year. The result would be interim allocation difficulties, obscured operating results, and complicated analysis and understandability of interim period information.

EFFECTIVE DATE

46. ***This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1999. Earlier application is encouraged.***

INTERNATIONAL ACCOUNTING STANDARD IAS 35**Discontinuing Operations**

This International Accounting Standard was approved by the IASC Board in April 1998 and became effective for financial statements covering periods beginning on or after 1 January 1999.

This Standard supersedes paragraphs 19 to 22 of IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies.

In 1999, paragraph 8 of the introduction, paragraphs 20, 21, 29, 30 and 32 of the Standard, and paragraph 4 of Appendix B were amended to conform to the terminology used in IAS 10 (revised 1999), events after the balance sheet date and IAS 37, provisions, contingent liabilities and contingent assets.

INTRODUCTION

1. This Standard (IAS 35) addresses presentation and disclosures relating to discontinuing operations. That matter had been dealt with relatively briefly in paragraphs 19 to 22 of IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies. IAS 35 supersedes those paragraphs of IAS 8. IAS 35 is effective for financial statements for periods beginning on or after 1 January 1999. Earlier application is encouraged.
2. The objectives of IAS 35 are to establish a basis for segregating information about a major operation that an enterprise is discontinuing from information about its continuing operations and to specify minimum disclosures about a discontinuing operation. Distinguishing discontinuing and continuing operations improves the ability of investors, creditors, and other users of financial statements to make projections of the enterprise's cash flows, earnings-generating capacity, and financial position.
3. A discontinuing operation is a relatively large component of an enterprise — such as a business or geographical segment under IAS 14, segment reporting — that the enterprise, pursuant to a single plan, either is disposing of substantially in its entirety or is terminating through abandonment or piecemeal sale.

4. This Standard uses the term 'discontinuing operation' rather than the traditional 'discontinued operation' because 'discontinued operation' (past tense) implies that recognition of a discontinuance is necessary only at or near the end of the process of discontinuing the operation. This Standard requires that disclosures about a discontinuing operation begin earlier than that — when a detailed formal plan for disposal has been adopted and announced or when the enterprise has already contracted for the disposal.
5. This is a presentation and disclosure Standard. It focuses on how to present a discontinuing operation in an enterprise's financial statements and what information to disclose. It does not establish any new principles for deciding when and how to recognise and measure the income, expenses, cash flows, and changes in assets and liabilities relating to a discontinuing operation. Instead, it requires that enterprises follow the recognition and measurement principles in other International Accounting Standards.
6. Under this Standard, information about a planned discontinuance must initially be disclosed in the first set of financial statements issued by an enterprise after (a) it has entered into an agreement to sell substantially all of the assets of the discontinuing operation or (b) its board of directors or other similar governing body has both approved and announced the planned discontinuance. Required disclosures include:
 - a description of the discontinuing operation,
 - the business or geographical segment(s) in which it is reported,
 - the date and nature of the initial disclosure event,
 - the timing of expected completion,
 - the carrying amounts of the total assets and the total liabilities to be disposed of,
 - the amounts of revenue, expenses, and pre-tax profit or loss attributable to the discontinuing operation, and related income tax expense,
 - the net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation,
 - the amount of any gain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation, and related income tax expense, and
 - the net selling prices, after disposal costs, from the sale of those net assets for which the enterprise has entered into one or more binding sale agreements, and the expected timing thereof, and the carrying amounts of those net assets.
7. Financial statements for periods after initial disclosure must update those disclosures, including a description of any significant changes in the amount or timing of cash flows relating to the assets and liabilities to be disposed of or settled and the causes of those changes.
8. The disclosures would be made if a plan for disposal is approved and publicly announced after the end of an enterprise's financial reporting period but before the financial statements for that period are authorised for issue. The disclosures continue until completion of the disposal.
9. Comparative information for prior periods that is presented in financial statements prepared after initial disclosure must be restated to segregate the continuing and discontinuing assets, liabilities, income, expenses, and cash flows. By separating discontinuing and continuing operations retrospectively, the ability of a user of financial statements to make projections is improved.

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

OBJECTIVE

The objective of this Standard is to establish principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise's cash flows, earnings-generating capacity, and financial position by segregating information about discontinuing operations from information about continuing operations.

SCOPE

1. ***This Standard applies to all discontinuing operations of all enterprises.***

DEFINITIONS

Discontinuing operation

2. ***A discontinuing operation is a component of an enterprise:***
 - (a) ***that the enterprise, pursuant to a single plan, is:***
 - (i) ***disposing of substantially in its entirety, such as by selling the component in a single transaction, by demerger or spin-off of ownership of the component to the enterprise's shareholders;***
 - (ii) ***disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or***
 - (iii) ***terminating through abandonment;***
 - (b) ***that represents a separate major line of business or geographical area of operations; and***
 - (c) ***that can be distinguished operationally and for financial reporting purposes.***
3. Under criterion (a) of the definition (paragraph 2(a)), a discontinuing operation may be disposed of in its entirety or piecemeal, but always pursuant to an overall plan to discontinue the entire component.
4. If an enterprise sells a component substantially in its entirety, the result can be a net gain or net loss. For such a discontinuance, there is a single date at which a binding sale agreement is entered into, although the actual transfer of possession and control of the discontinuing operation may occur at a later date. Also, payments to the seller may occur at the time of the agreement, at the time of the transfer, or over an extended future period.
5. Instead of disposing of a major component in its entirety, an enterprise may discontinue and dispose of the component by selling its assets and settling its liabilities piecemeal (individually or in small groups). For piecemeal disposals, while the overall result may be a net gain or a net loss, the sale of an individual asset or settlement of an individual liability may have the opposite effect. Moreover, there is no single date at which an overall binding sale agreement is entered into. Rather, the sales of assets and settlements of liabilities may occur over a period of months or perhaps even longer, and the end of a financial reporting period may occur part way through the disposal period. To qualify as a discontinuing operation, the disposal must be pursuant to a single co-ordinated plan.
6. An enterprise may terminate an operation by abandonment without substantial sales of assets. An abandoned operation would be a discontinuing operation if it satisfies the criteria in the definition. However, changing the scope of an operation or the manner in which it is conducted is not an abandonment because that operation, although changed, is continuing.
7. Business enterprises frequently close facilities, abandon products or even product lines, and change the size of their work force in response to market forces. While those kinds of terminations generally are not, in and of themselves, discontinuing operations as that term is used in this Standard, they can occur in connection with a discontinuing operation.
8. Examples of activities that do not necessarily satisfy criterion (a) of paragraph 2, but that might do so in combination with other circumstances, include:
 - (a) gradual or evolutionary phasing out of a product line or class of service;

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- (b) discontinuing, even if relatively abruptly, several products within an ongoing line of business;
 - (c) shifting of some production or marketing activities for a particular line of business from one location to another;
 - (d) closing of a facility to achieve productivity improvements or other cost savings; and
 - (e) selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.
9. A reportable business segment or geographical segment as defined in IAS 14, segment reporting, would normally satisfy criterion (b) of the definition of a discontinuing operation (paragraph 2(b)), that is, it would represent a separate major line of business or geographical area of operations. A part of a segment as defined in IAS 14 may also satisfy criterion (b) of the definition. For an enterprise that operates in a single business or geographical segment and therefore does not report segment information, a major product or service line may also satisfy the criteria of the definition.
10. IAS 14 permits, but does not require, that different stages of vertically integrated operations be identified as separate business segments. Such vertically integrated business segments may satisfy criterion (b) of the definition of a discontinuing operation.
11. A component can be distinguished operationally and for financial reporting purposes — criterion (c) of the definition (paragraph 2(c)) — if:
- (a) its operating assets and liabilities can be directly attributed to it;
 - (b) its income (gross revenue) can be directly attributed to it; and
 - (c) at least a majority of its operating expenses can be directly attributed to it.
12. Assets, liabilities, income, and expenses are directly attributable to a component if they would be eliminated when the component is sold, abandoned or otherwise disposed of. Interest and other financing cost is attributed to a discontinuing operation only if the related debt is similarly attributed.
13. As defined in this Standard, discontinuing operations are expected to occur relatively infrequently. Some changes that are not classified as discontinuing operations may qualify as restructurings (see IAS 37, provisions, contingent liabilities and contingent assets).
14. Also, some infrequently occurring events that do not qualify either as discontinuing operations or restructurings may result in items of income or expense that require separate disclosure pursuant to IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies, because their size, nature, or incidence make them relevant to explain the performance of the enterprise for the period.
15. The fact that a disposal of a component of an enterprise is classified as a discontinuing operation under this Standard does not, in itself, bring into question the enterprise's ability to continue as a going concern. IAS 1, presentation of financial statements, requires disclosure of uncertainties relating to an enterprise's ability to continue as a going concern and of any conclusion that an enterprise is not a going concern.

Initial disclosure event

16. ***With respect to a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:***
- (a) ***the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or***
 - (b) ***the enterprise's board of directors or similar governing body has both (i) approved a detailed, formal plan for the discontinuance and (ii) made an announcement of the plan.***

RECOGNITION AND MEASUREMENT

17. ***An enterprise should apply the principles of recognition and measurement that are set out in other International Accounting Standards for the purpose of deciding when and how to recognise and measure the changes in assets and liabilities and the income, expenses, and cash flows relating to a discontinuing operation.***
18. This Standard does not establish any recognition and measurement principles. Rather, it requires that an enterprise follow recognition and measurement principles established in other Standards. Two Standards that are likely to be relevant in this regard are:
- (a) IAS 36, impairment of assets; and
 - (b) IAS 37, provisions, contingent liabilities and contingent assets.
19. Other Standards that may be relevant include IAS 19, employee benefits, with respect to recognition of termination benefits, and IAS 16, property, plant and equipment, with respect to disposals of those kinds of assets.

Provisions

20. A discontinuing operation is a restructuring as that term is defined in IAS 37, provisions, contingent liabilities and contingent assets. IAS 37 provides guidance for certain of the requirements of this Standard, including:
- (a) what constitutes a 'detailed, formal plan for the discontinuance' as that term is used in paragraph 16(b) of this Standard; and
 - (b) what constitutes an 'announcement of the plan' as that term is used in paragraph 16(b) of this Standard.
21. IAS 37 defines when a provision should be recognised. In some cases, the event that obligates the enterprise occurs after the end of a financial reporting period but before the financial statements for that period have been authorised for issue. Paragraph 29 of this Standard requires disclosures about a discontinuing operation in such cases.

Impairment losses

22. The approval and announcement of a plan for discontinuance is an indication that the assets attributable to the discontinuing operation may be impaired or that an impairment loss previously recognised for those assets should be increased or reversed. Therefore, in accordance with IAS 36, impairment of assets, an enterprise estimates the recoverable amount of each asset of the discontinuing operation (the higher of the asset's net selling price and its value in use) and recognises an impairment loss or reversal of a prior impairment loss, if any.
23. In applying IAS 36 to a discontinuing operation, an enterprise determines whether the recoverable amount of an asset of a discontinuing operation is assessed for the individual asset or for the asset's cash-generating unit (defined in IAS 36 as the smallest identifiable group of assets that includes the asset under review and that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets). For example:
- (a) if the enterprise sells the discontinuing operation substantially in its entirety, none of the assets of the discontinuing operation generate cash inflows independently from other assets within the discontinuing operation. Therefore, recoverable amount is determined for the discontinuing operation as a whole and an impairment loss, if any, is allocated among the assets of the discontinuing operation in accordance with IAS 36;
 - (b) if the enterprise disposes of the discontinuing operation in other ways such as piecemeal sales, the recoverable amount is determined for individual assets, unless the assets are sold in groups; and
 - (c) if the enterprise abandons the discontinuing operation, the recoverable amount is determined for individual assets as set out in IAS 36.

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24. After announcement of a plan, negotiations with potential purchasers of the discontinuing operation or actual binding sale agreements may indicate that the assets of the discontinuing operation may be further impaired or that impairment losses recognised for these assets in prior periods may have decreased. As a consequence, when such events occur, an enterprise re-estimates the recoverable amount of the assets of the discontinuing operation and recognises resulting impairment losses or reversals of impairment losses in accordance with IAS 36.
25. A price in a binding sale agreement is the best evidence of an asset's (cash-generating unit's) net selling price or of the estimated cash inflow from ultimate disposal in determining the asset's (cash-generating unit's) value in use.
26. The carrying amount (recoverable amount) of a discontinuing operation includes the carrying amount (recoverable amount) of any goodwill that can be allocated on a reasonable and consistent basis to that discontinuing operation.

PRESENTATION AND DISCLOSURE

Initial disclosure

27. ***An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 16) occurs:***
 - (a) ***a description of the discontinuing operation;***
 - (b) ***the business or geographical segment(s) in which it is reported in accordance with IAS 14;***
 - (c) ***the date and nature of the initial disclosure event;***
 - (d) ***the date or period in which the discontinuance is expected to be completed if known or determinable;***
 - (e) ***the carrying amounts, as of the balance sheet date, of the total assets and the total liabilities to be disposed of;***
 - (f) ***the amounts of revenue, expenses, and pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense relating thereto as required by paragraph 81(h) of IAS 12; and***
 - (g) ***the amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.***
28. In measuring the assets, liabilities, revenues, expenses, gains, losses, and cash flows of a discontinuing operation for the purpose of the disclosures required by this Standard, such items can be attributed to a discontinuing operation if they will be disposed of, settled, reduced, or eliminated when the discontinuance is completed. To the extent that such items continue after completion of the discontinuance, they should not be allocated to the discontinuing operation.
29. ***If an initial disclosure event occurs after the end of an enterprise's financial reporting period but before the financial statements for that period are authorised for issue, those financial statements should include the disclosures specified in paragraph 27 for the period covered by those financial statements.***
30. For example, the board of directors of an enterprise whose financial year ends 31 December 20X5 approves a plan for a discontinuing operation on 15 December 20X5 and announces that plan on 10 January 20X6. The board authorises the financial statements for 20X5 for issue on 20 March 20X6. The financial statements for 20X5 include the disclosures required by paragraph 27.

Other disclosures

31. ***When an enterprise disposes of assets or settles liabilities attributable to a discontinuing operation or enters into binding agreements for the sale of such assets or the settlement of such liabilities, it should include in its financial statements the following information when the events occur:***
- (a) ***for any gain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation, (i) the amount of the pre-tax gain or loss and (ii) income tax expense relating to the gain or loss, as required by paragraph 81(h) of IAS 12; and***
 - (b) ***the net selling price or range of prices (which is after deducting the expected disposal costs) of those net assets for which the enterprise has entered into one or more binding sale agreements, the expected timing of receipt of those cash flows, and the carrying amount of those net assets.***
32. The asset disposals, liability settlements, and binding sale agreements referred to in the preceding paragraph may occur concurrently with the initial disclosure event, or in the period in which the initial disclosure event occurs, or in a later period. In accordance with IAS 10, events after the balance sheet date, if some of the assets attributable to a discontinuing operation have actually been sold or are the subject of one or more binding sale agreements entered into after the financial year end but before the board approves the financial statements for issue, the financial statements include the disclosures required by paragraph 31 if non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.

Updating the disclosures

33. ***In addition to the disclosures in paragraphs 27 and 31, an enterprise should include in its financial statements for periods subsequent to the one in which the initial disclosure event occurs a description of any significant changes in the amount or timing of cash flows relating to the assets and liabilities to be disposed of or settled and the events causing those changes.***
34. Examples of events and activities that would be disclosed include the nature and terms of binding sale agreements for the assets, a demerger of the assets via spin-off of a separate equity security to the enterprise's shareholders, and legal or regulatory approvals.
35. ***The disclosures required by paragraphs 27 to 34 should continue in financial statements for periods up to and including the period in which the discontinuance is completed. A discontinuance is completed when the plan is substantially completed or abandoned, though payments from the buyer(s) to the seller may not yet be completed.***
36. ***If an enterprise abandons or withdraws from a plan that was previously reported as a discontinuing operation, that fact and its effect should be disclosed.***
37. For the purpose of applying the preceding paragraph, disclosure of the effect includes reversal of any prior impairment loss or provision that was recognised with respect to the discontinuing operation.

Separate disclosure for each discontinuing operation

38. ***Any disclosures required by this Standard should be presented separately for each discontinuing operation.***

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Face of financial statements or notes

39. ***The disclosures required by paragraphs 27 to 37 may be presented either in the notes to the financial statements or on the face of the financial statements except that the disclosure of the amount of the pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation (paragraph 31(a)) should be shown on the face of the income statement.***
40. The disclosures required by paragraphs 27(f) and 27(g) are encouraged to be presented on the face of the income statement and cash flow statement, respectively.

Not an extraordinary item

41. ***A discontinuing operation should not be presented as an extraordinary item.***
42. IAS 8 defines extraordinary items as 'income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly.' The two examples of extraordinary items cited in IAS 8 are expropriations of assets and natural disasters, both of which are types of events that are not within the control of the management of the enterprise. As defined in this Standard, a discontinuing operation must be based on a single plan by an enterprise's management to sell or otherwise dispose of a major portion of the business.

Restricted use of the term 'discontinuing operation'

43. ***A restructuring, transaction, or event that does not meet the definition of a discontinuing operation in this Standard should not be called a discontinuing operation.***

Illustrative disclosures

44. Appendix A provides examples of the presentation and disclosures required by this Standard.

Restatement of prior periods

45. ***Comparative information for prior periods that is presented in financial statements prepared after the initial disclosure event should be restated to segregate continuing and discontinuing assets, liabilities, income, expenses, and cash flows in a manner similar to that required by paragraphs 27 to 43.***
46. Appendix B illustrates application of the preceding paragraph.

Disclosure in interim financial reports

47. ***The notes to an interim financial report should describe any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation and any significant changes in the amount or timing of cash flows relating to the assets and liabilities to be disposed of or settled.***
48. This principle is consistent with the approach in IAS 34, interim financial reporting, that the notes to an interim financial report are intended to explain significant changes since the last annual reporting date.

EFFECTIVE DATE

49. ***This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1999. Earlier application is encouraged in financial statements for periods ending after this Standard is published.***
50. This Standard supersedes paragraphs 19 to 22 of IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies.

INTERNATIONAL ACCOUNTING STANDARD IAS 36

Impairment of assets

This International Accounting Standard was approved by the IASC Board in April 1998 and becomes effective for financial statements covering periods beginning on or after 1 July 1999.

In July 1998, the approval of IAS 38, intangible assets, and IAS 22 (revised 1998), business combinations, resulted in changes in cross-references and terminology to the introduction and paragraphs 39, 40 and 110. In addition, IAS 38 added a definition of 'active market' to paragraph 5. Finally, a minor wording inconsistency in Appendix A, paragraphs A47, A48 and A57, was corrected.

In April 2000, IAS 40, investment property, amended paragraph 1. The amendment is effective for financial statements covering periods beginning on or after 1 January 2001.

In January 2001, IAS 41, Agriculture amended paragraph 1. The amendment is effective for financial statements covering periods beginning on or after 1 January 2003.

INTRODUCTION

1. This Standard ('IAS 36') prescribes the accounting and disclosure for impairment of all assets. It replaces the requirements for assessing the recoverability of an asset and recognising impairment losses that were included in:
 - (a) IAS 16 (revised 1993), property, plant and equipment (see IAS 16 (revised 1998));
 - (b) IAS 22 (revised 1993), business combinations (see IAS 22 (revised 1998));
 - (c) IAS 28 (reformatted 1994), accounting for investments in associates (see IAS 28 (revised 1998)); and
 - (d) IAS 31 (reformatted 1994), financial reporting of interests in joint ventures (see IAS 31 (revised 1998)).

The major changes from previous requirements and explanations for the principles in IAS 36 are set out in a separate basis for conclusions.

2. IAS 36 does not cover impairment of inventories, deferred tax assets, assets arising from construction contracts, assets arising from employee benefits or most financial assets.
3. IAS 36 requires that the recoverable amount of an asset should be estimated whenever there is an indication that the asset may be impaired. In specific cases, the International Accounting Standard applicable to an asset may include requirements for additional reviews. For example, IAS 38, intangible assets, and IAS 22 (revised 1998), business combinations, require that the recoverable amount of intangible assets and goodwill that are amortised over more than 20 years should be estimated annually.
4. IAS 36 requires an impairment loss to be recognised (an asset is impaired) whenever the carrying amount of an asset exceeds its recoverable amount. An impairment loss should be recognised in the income statement for assets carried at cost and treated as a revaluation decrease for assets carried at revalued amount.
5. IAS 36 requires recoverable amount to be measured as the higher of net selling price and value in use:
 - (a) net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, after deducting any direct incremental disposal costs; and
 - (b) value in use is the present value of estimated future cash flows expected to arise from continuing use of an asset and from its disposal at the end of its useful life.

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6. In determining an asset's value in use, IAS 36 requires that an enterprise should use, among other things:
 - (a) cash flow projections based on reasonable and supportable assumptions that:
 - (i) reflect the asset in its current condition; and
 - (ii) represent management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset; and
 - (b) a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. The discount rate should not reflect risks for which future cash flows have been adjusted.
7. Recoverable amount should be estimated for an individual asset. If it is not possible to do so, IAS 36 requires an enterprise to determine recoverable amount for the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets. However, if the output produced by an asset or group of assets is traded in an active market, this asset or group of assets should be identified as a separate cash-generating unit, even if some or all of the production of this asset or group of assets is used internally. Appendix A, illustrative examples, includes examples on the identification of cash-generating units.
8. In testing a cash-generating unit for impairment, IAS 36 requires that goodwill and corporate assets (such as head office assets) that relate to the cash-generating unit should be considered. IAS 36 specifies how this should be done.
9. Principles for recognising and measuring impairment losses for a cash-generating unit are the same as those for an individual asset. IAS 36 specifies how to determine the carrying amount of a cash-generating unit and how to allocate an impairment loss between the assets of the unit.
10. IAS 36 requires that an impairment loss recognised in prior years should be reversed if, and only if, there has been a change in the estimates used to determine recoverable amount since the last impairment loss was recognised. However, an impairment loss is reversed only to the extent that it does not increase the carrying amount of an asset above the carrying amount that would have been determined for the asset (net of amortisation or depreciation) had no impairment loss been recognised in prior years. A reversal of an impairment loss should be recognised in the income statement for assets carried at cost and treated as a revaluation increase for assets carried at revalued amount.
11. IAS 36 requires that an impairment loss for goodwill should not be reversed unless:
 - (a) the impairment loss was caused by a specific external event of an exceptional nature that is not expected to recur; and
 - (b) subsequent external events have reversed the effect of that event.
12. When impairment losses are recognised (reversed), IAS 36 requires certain information to be disclosed:
 - (a) by class of assets; and
 - (b) by reportable segments based on the enterprise's primary format (only required if an enterprise applies IAS 14, segment reporting).

IAS 36 requires further disclosure if impairment losses recognised (reversed) during the period are material to the financial statements of the reporting enterprise as a whole.

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13. On first adoption, IAS 36 should be applied on a prospective basis only. Impairment losses recognised (reversed) should be treated under IAS 36 and not under the benchmark or the allowed alternative treatment for other changes in accounting policies in IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies.
14. IAS 36 is effective for accounting periods beginning on or after 1 July 1999. Earlier application is encouraged.

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

OBJECTIVE

The objective of this Standard is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and the Standard requires the enterprise to recognise an impairment loss. The Standard also specifies when an enterprise should reverse an impairment loss and it prescribes certain disclosures for impaired assets.

SCOPE

1. ***This Standard should be applied in accounting for the impairment of all assets, other than:***
 - (a) ***inventories (see IAS 2, inventories);***
 - (b) ***assets arising from construction contracts (see IAS 11, construction contracts);***
 - (c) ***deferred tax assets (see IAS 12, income taxes);***
 - (d) ***assets arising from employee benefits (see IAS 19, employee benefits);***
 - (e) ***financial assets that are included in the scope of IAS 32, financial instruments: disclosure and presentation;***
 - (f) ***investment property that is measured at fair value (see IAS 40, investment Property); and***
 - (g) ***biological assets related to agricultural activity that are measured at fair value less estimated point-of-sale costs (see IAS 41, agriculture).***
2. This Standard does not apply to inventories, assets arising from construction contracts, deferred tax assets or assets arising from employee benefits because existing International Accounting Standards applicable to these assets already contain specific requirements for recognising and measuring these assets.
3. This Standard applies to:
 - (a) subsidiaries, as defined in IAS 27, consolidated financial statements and accounting for investments in subsidiaries;
 - (b) associates, as defined in IAS 28, accounting for investments in associates; and
 - (c) joint ventures, as defined in IAS 31, financial reporting of interests in joint ventures.

For impairment of other financial assets, refer to IAS 39, Financial Instruments: Recognition and Measurement.
4. This Standard applies to assets that are carried at revalued amount (fair value) under other International Accounting Standards, such as the allowed alternative treatment in IAS 16, property, plant and equipment. However, identifying whether a revalued asset may be impaired depends on the basis used to determine fair value:
 - (a) if the asset's fair value is its market value, the only difference between the asset's fair value and its net selling price is the direct incremental costs to dispose of the asset:

- (i) if the disposal costs are negligible, the recoverable amount of the revalued asset is necessarily close to, or greater than, its revalued amount (fair value). In this case, after the revaluation requirements have been applied, it is unlikely that the revalued asset is impaired and recoverable amount need not be estimated; and
 - (ii) if the disposal costs are not negligible, net selling price of the revalued asset is necessarily less than its fair value. Therefore, the revalued asset will be impaired if its value in use is less than its revalued amount (fair value). In this case, after the revaluation requirements have been applied, an enterprise applies this Standard to determine whether the asset may be impaired; and
- (b) if the asset's fair value is determined on a basis other than its market value, its revalued amount (fair value) may be greater or lower than its recoverable amount. Hence, after the revaluation requirements have been applied, an enterprise applies this Standard to determine whether the asset may be impaired.

DEFINITIONS

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

Recoverable amount is the higher of an asset's net selling price and its value in use.

Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.

Costs of disposal are incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.

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

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

Depreciation (amortisation) is the systematic allocation of the depreciable amount of an asset over its useful life⁽¹⁾.

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

Useful life is either:

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

A cash-generating unit is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.

⁽¹⁾ In the case of an intangible asset or goodwill, the term 'amortisation' is generally used instead of 'depreciation'. Both terms have the same meaning.

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Corporate assets are assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units.

An active market is a market where all the following conditions exist:

- (a) **the items traded within the market are homogeneous;**
- (b) **willing buyers and sellers can normally be found at any time; and**
- (c) **prices are available to the public.**

IDENTIFYING AN ASSET THAT MAY BE IMPAIRED

- 6. Paragraphs 7 to 14 specify when recoverable amount should be determined. These requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit.
- 7. An asset is impaired when the carrying amount of the asset exceeds its recoverable amount. Paragraphs 9 to 11 describe some indications that an impairment loss may have occurred: if any of those indications is present, an enterprise is required to make a formal estimate of recoverable amount. If no indication of a potential impairment loss is present, this Standard does not require an enterprise to make a formal estimate of recoverable amount.
- 8. **An enterprise should assess at each balance sheet date whether there is any indication that an asset may be impaired. If any such indication exists, the enterprise should estimate the recoverable amount of the asset.**
- 9. **In assessing whether there is any indication that an asset may be impaired, an enterprise should consider, as a minimum, the following indications:**

External sources of information

- (a) **during the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use;**
- (b) **significant changes with an adverse effect on the enterprise have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the enterprise operates or in the market to which an asset is dedicated;**
- (c) **market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially;**
- (d) **the carrying amount of the net assets of the reporting enterprise is more than its market capitalisation;**

Internal sources of information

- (e) **evidence is available of obsolescence or physical damage of an asset;**
- (f) **significant changes with an adverse effect on the enterprise have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include plans to discontinue or restructure the operation to which an asset belongs or to dispose of an asset before the previously expected date; and**
- (g) **evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.**

10. The list in paragraph 9 is not exhaustive. An enterprise may identify other indications that an asset may be impaired and these would also require the enterprise to determine the asset's recoverable amount.
11. Evidence from internal reporting that indicates that an asset may be impaired includes the existence of:
- (a) cash flows for acquiring the asset, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted;
 - (b) actual net cash flows or operating profit or loss flowing from the asset that are significantly worse than those budgeted;
 - (c) a significant decline in budgeted net cash flows or operating profit, or a significant increase in budgeted loss, flowing from the asset; or
 - (d) operating losses or net cash outflows for the asset, when current period figures are aggregated with budgeted figures for the future.
12. The concept of materiality applies in identifying whether the recoverable amount of an asset needs to be estimated. For example, if previous calculations show that an asset's recoverable amount is significantly greater than its carrying amount, the enterprise need not re-estimate the asset's recoverable amount if no events have occurred that would eliminate that difference. Similarly, previous analysis may show that an asset's recoverable amount is not sensitive to one (or more) of the indications listed in paragraph 9.
13. As an illustration of paragraph 12, if market interest rates or other market rates of return on investments have increased during the period, an enterprise is not required to make a formal estimate of an asset's recoverable amount in the following cases:
- (a) if the discount rate used in calculating the asset's value in use is unlikely to be affected by the increase in these market rates. For example, increases in short-term interest rates may not have a material effect on the discount rate used for an asset that has a long remaining useful life; or
 - (b) if the discount rate used in calculating the asset's value in use is likely to be affected by the increase in these market rates but previous sensitivity analysis of recoverable amount shows that:
 - (i) it is unlikely that there will be a material decrease in recoverable amount because future cash flows are also likely to increase. For example, in some cases, an enterprise may be able to demonstrate that it adjusts its revenues to compensate for any increase in market rates; or
 - (ii) the decrease in recoverable amount is unlikely to result in a material impairment loss.
14. If there is an indication that an asset may be impaired, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value for the asset need to be reviewed and adjusted under the International Accounting Standard applicable to the asset, even if no impairment loss is recognised for the asset.

MEASUREMENT OF RECOVERABLE AMOUNT

15. This Standard defines recoverable amount as the higher of an asset's net selling price and value in use. Paragraphs 16 to 56 set out the requirements for measuring recoverable amount. These requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit.

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16. It is not always necessary to determine both an asset's net selling price and its value in use. For example, if either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.
17. It may be possible to determine net selling price, even if an asset is not traded in an active market. However, sometimes it will not be possible to determine net selling price because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the recoverable amount of the asset may be taken to be its value in use.
18. If there is no reason to believe that an asset's value in use materially exceeds its net selling price, the asset's recoverable amount may be taken to be its net selling price. This will often be the case for an asset that is held for disposal. This is because the value in use of an asset held for disposal will consist mainly of the net disposal proceeds, since the future cash flows from continuing use of the asset until its disposal are likely to be negligible.
19. Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows from continuing use that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs (see paragraphs 64 to 87), unless either:
 - (a) the asset's net selling price is higher than its carrying amount; or
 - (b) the asset's value in use can be estimated to be close to its net selling price and net selling price can be determined.
20. In some cases, estimates, averages and computational shortcuts may provide a reasonable approximation of the detailed computations illustrated in this Standard for determining net selling price or value in use.

Net selling price

21. The best evidence of an asset's net selling price is a price in a binding sale agreement in an arm's length transaction, adjusted for incremental costs that would be directly attributable to the disposal of the asset.
22. If there is no binding sale agreement but an asset is traded in an active market, net selling price is the asset's market price less the costs of disposal. The appropriate market price is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction may provide a basis from which to estimate net selling price, provided that there has not been a significant change in economic circumstances between the transaction date and the date at which the estimate is made.
23. If there is no binding sale agreement or active market for an asset, net selling price is based on the best information available to reflect the amount that an enterprise could obtain, at the balance sheet date, for the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, an enterprise considers the outcome of recent transactions for similar assets within the same industry. Net selling price does not reflect a forced sale, unless management is compelled to sell immediately.
24. Costs of disposal, other than those that have already been recognised as liabilities, are deducted in determining net selling price. Examples of such costs are legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale. However, termination benefits (as defined in IAS 19, employee benefits) and costs associated with reducing or reorganising a business following the disposal of an asset are not direct incremental costs to dispose of the asset.

25. Sometimes, the disposal of an asset would require the buyer to take over a liability and only a single net selling price is available for both the asset and the liability. Paragraph 77 explains how to deal with such cases.

Value in use

26. Estimating the value in use of an asset involves the following steps:
- (a) estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and
 - (b) applying the appropriate discount rate to these future cash flows.

Basis for estimates of future cash flows

27. ***In measuring value in use:***
- (a) ***cash flow projections should be based on reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset. Greater weight should be given to external evidence;***
 - (b) ***cash flow projections should be based on the most recent financial budgets/forecasts that have been approved by management. Projections based on these budgets/forecasts should cover a maximum period of five years, unless a longer period can be justified; and***
 - (c) ***cash flow projections beyond the period covered by the most recent budgets/forecasts should be estimated by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate should not exceed the long-term average growth rate for the products, industries, or country or countries in which the enterprise operates, or for the market in which the asset is used, unless a higher rate can be justified.***
28. Detailed, explicit and reliable financial budgets/forecasts of future cash flows for periods longer than five years are generally not available. For this reason, management's estimates of future cash flows are based on the most recent budgets/forecasts for a maximum of five years. Management may use cash flow projections based on financial budgets/forecasts over a period longer than five years if management is confident that these projections are reliable and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period.
29. Cash flow projections until the end of an asset's useful life are estimated by extrapolating the cash flow projections based on the financial budgets/forecasts using a growth rate for subsequent years. This rate is steady or declining, unless an increase in the rate matches objective information about patterns over a product or industry lifecycle. If appropriate, the growth rate is zero or negative.
30. Where conditions are very favourable, competitors are likely to enter the market and restrict growth. Therefore, enterprises will have difficulty in exceeding the average historical growth rate over the long term (say, 20 years) for the products, industries, or country or countries in which the enterprise operates, or for the market in which the asset is used.
31. In using information from financial budgets/forecasts, an enterprise considers whether the information reflects reasonable and supportable assumptions and represents management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset.

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Composition of estimates of future cash flows

32. **Estimates of future cash flows should include:**
- (a) **projections of cash inflows from the continuing use of the asset;**
 - (b) **projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset for use) and that can be directly attributed, or allocated on a reasonable and consistent basis, to the asset; and**
 - (c) **net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life.**
33. Estimates of future cash flows and the discount rate reflect consistent assumptions about price increases due to general inflation. Therefore, if the discount rate includes the effect of price increases due to general inflation, future cash flows are estimated in nominal terms. If the discount rate excludes the effect of price increases due to general inflation, future cash flows are estimated in real terms (but include future specific price increases or decreases).
34. Projections of cash outflows include future overheads that can be attributed directly, or allocated on a reasonable and consistent basis, to the use of the asset.
35. When the carrying amount of an asset does not yet include all the cash outflows to be incurred before it is ready for use or sale, the estimate of future cash outflows includes an estimate of any further cash outflow that is expected to be incurred before the asset is ready for use or sale. For example, this is the case for a building under construction or for a development project that is not yet completed.
36. To avoid double counting, estimates of future cash flows do not include:
- (a) cash inflows from assets that generate cash inflows from continuing use that are largely independent of the cash inflows from the asset under review (for example, financial assets such as receivables); and
 - (b) cash outflows that relate to obligations that have already been recognised as liabilities (for example, payables, pensions or provisions).
37. **Future cash flows should be estimated for the asset in its current condition. Estimates of future cash flows should not include estimated future cash inflows or outflows that are expected to arise from:**
- (a) **a future restructuring to which an enterprise is not yet committed; or**
 - (b) **future capital expenditure that will improve or enhance the asset in excess of its originally assessed standard of performance.**
38. Because future cash flows are estimated for the asset in its current condition, value in use does not reflect:
- (a) future cash outflows or related cost savings (for example reductions in staff costs) or benefits that are expected to arise from a future restructuring to which an enterprise is not yet committed; or
 - (b) future capital expenditure that will improve or enhance the asset in excess of its originally assessed standard of performance or the related future benefits from this future expenditure.
39. A restructuring is a programme that is planned and controlled by management and that materially changes either the scope of the business undertaken by an enterprise or the manner in which the business is conducted. IAS 37, provisions, contingent liabilities and contingent assets, gives guidance that may clarify when an enterprise is committed to a restructuring.

40. When an enterprise becomes committed to a restructuring, some assets are likely to be affected by this restructuring. Once the enterprise is committed to the restructuring:
- (a) in determining value in use, estimates of future cash inflows and cash outflows reflect the cost savings and other benefits from the restructuring (based on the most recent financial budgets/forecasts that have been approved by management); and
 - (b) estimates of future cash outflows for the restructuring are dealt with in a restructuring provision under IAS 37, provisions, contingent liabilities and contingent assets.

Appendix A, Example 5, illustrates the effect of a future restructuring on a value in use calculation.

41. Until an enterprise incurs capital expenditure that improves or enhances an asset in excess of its originally assessed standard of performance, estimates of future cash flows do not include the estimated future cash inflows that are expected to arise from this expenditure (see Appendix A, Example 6).
42. Estimates of future cash flows include future capital expenditure necessary to maintain or sustain an asset at its originally assessed standard of performance.
43. **Estimates of future cash flows should not include:**
- (a) **cash inflows or outflows from financing activities; or**
 - (b) **income tax receipts or payments.**
44. Estimated future cash flows reflect assumptions that are consistent with the way the discount rate is determined. Otherwise, the effect of some assumptions will be counted twice or ignored. Because the time value of money is considered by discounting the estimated future cash flows, these cash flows exclude cash inflows or outflows from financing activities. Similarly, since the discount rate is determined on a pre-tax basis, future cash flows are also estimated on a pre-tax basis.
45. **The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life should be the amount that an enterprise expects to obtain from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the estimated costs of disposal.**
46. The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life is determined in a similar way to an asset's net selling price, except that, in estimating those net cash flows:
- (a) an enterprise uses prices prevailing at the date of the estimate for similar assets that have reached the end of their useful life and that have operated under conditions similar to those in which the asset will be used; and
 - (b) those prices are adjusted for the effect of both future price increases due to general inflation and specific future price increases (decreases). However, if estimates of future cash flows from the asset's continuing use and the discount rate exclude the effect of general inflation, this effect is also excluded from the estimate of net cash flows on disposal.

Foreign currency future cash flows

47. Future cash flows are estimated in the currency in which they will be generated and then discounted using a discount rate appropriate for that currency. An enterprise translates the present value obtained using the spot exchange rate at the balance sheet date (described in IAS 21, the effects of changes in foreign exchange rates, as the closing rate).

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Discount rate

48. ***The discount rate (or rates) should be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the asset. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted.***
49. A rate that reflects current market assessments of the time value of money and the risks specific to the asset is the return that investors would require if they were to choose an investment that would generate cash flows of amounts, timing and risk profile equivalent to those that the enterprise expects to derive from the asset. This rate is estimated from the rate implicit in current market transactions for similar assets or from the weighted average cost of capital of a listed enterprise that has a single asset (or a portfolio of assets) similar in terms of service potential and risks to the asset under review.
50. When an asset-specific rate is not directly available from the market, an enterprise uses surrogates to estimate the discount rate. The purpose is to estimate, as far as possible, a market assessment of:
- (a) the time value of money for the periods until the end of the asset's useful life; and
 - (b) the risks that the future cash flows will differ in amount or timing from estimates.
51. As a starting point, the enterprise may take into account the following rates:
- (a) the enterprise's weighted average cost of capital determined using techniques such as the capital asset pricing model;
 - (b) the enterprise's incremental borrowing rate; and
 - (c) other market borrowing rates.
52. These rates are adjusted:
- (a) to reflect the way that the market would assess the specific risks associated with the projected cash flows; and
 - (b) to exclude risks that are not relevant to the projected cash flows.
- Consideration is given to risks such as country risk, currency risk, price risk and cash flow risk.
53. To avoid double counting, the discount rate does not reflect risks for which future cash flow estimates have been adjusted.
54. The discount rate is independent of the enterprise's capital structure and the way the enterprise financed the purchase of the asset because the future cash flows expected to arise from an asset do not depend on the way in which the enterprise financed the purchase of the asset.
55. When the basis for the rate is post-tax, that basis is adjusted to reflect a pre-tax rate.
56. An enterprise normally uses a single discount rate for the estimate of an asset's value in use. However, an enterprise uses separate discount rates for different future periods where value in use is sensitive to a difference in risks for different periods or to the term structure of interest rates.

RECOGNITION AND MEASUREMENT OF AN IMPAIRMENT LOSS

57. Paragraphs 58 to 63 set out the requirements for recognising and measuring impairment losses for an individual asset. Recognition and measurement of impairment losses for a cash-generating unit are dealt with in paragraphs 88 to 93.
58. ***If, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. That reduction is an impairment loss.***
59. ***An impairment loss should be recognised as an expense in the income statement immediately, unless the asset is carried at revalued amount under another International Accounting Standard (for example, under the allowed alternative treatment in IAS 16, property, plant and equipment). Any impairment loss of a revalued asset should be treated as a revaluation decrease under that other International Accounting Standard.***
60. An impairment loss on a revalued asset is recognised as an expense in the income statement. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.
61. ***When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an enterprise should recognise a liability if, and only if, that is required by another International Accounting Standard.***
62. ***After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.***
63. If an impairment loss is recognised, any related deferred tax assets or liabilities are determined under IAS 12, income taxes, by comparing the revised carrying amount of the asset with its tax base (see Appendix A, Example 3).

CASH-GENERATING UNITS

64. Paragraphs 65 to 93 set out the requirements for identifying the cash-generating unit to which an asset belongs and determining the carrying amount of, and recognising impairment losses for, cash-generating units.

Identification of the cash-generating unit to which an asset belongs

65. ***If there is any indication that an asset may be impaired, recoverable amount should be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an enterprise should determine the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit).***
66. The recoverable amount of an individual asset cannot be determined if:
- (a) the asset's value in use cannot be estimated to be close to its net selling price (for example, when the future cash flows from continuing use of the asset cannot be estimated to be negligible); and
 - (b) the asset does not generate cash inflows from continuing use that are largely independent of those from other assets. In such cases, value in use and, therefore, recoverable amount, can be determined only for the asset's cash-generating unit.

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Example

A mining enterprise owns a private railway to support its mining activities. The private railway could be sold only for scrap value and the private railway does not generate cash inflows from continuing use that are largely independent of the cash inflows from the other assets of the mine.

It is not possible to estimate the recoverable amount of the private railway because the value in use of the private railway cannot be determined and it is probably different from scrap value. Therefore, the enterprise estimates the recoverable amount of the cash-generating unit to which the private railway belongs, that is, the mine as a whole.

67. As defined in paragraph 5, an asset's cash-generating unit is the smallest group of assets that includes the asset and that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets. Identification of an asset's cash-generating unit involves judgement. If recoverable amount cannot be determined for an individual asset, an enterprise identifies the lowest aggregation of assets that generate largely independent cash inflows from continuing use.

Example

A bus company provides services under contract with a municipality that requires minimum service on each of five separate routes. Assets devoted to each route and the cash flows from each route can be identified separately. One of the routes operates at a significant loss.

Because the enterprise does not have the option to curtail any one bus route, the lowest level of identifiable cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets is the cash inflows generated by the five routes together. The cash-generating unit for each route is the bus company as a whole.

68. Cash inflows from continuing use are inflows of cash and cash equivalents received from parties outside the reporting enterprise. In identifying whether cash inflows from an asset (or group of assets) are largely independent of the cash inflows from other assets (or groups of assets), an enterprise considers various factors including how management monitors the enterprise's operations (such as by product lines, businesses, individual locations, districts or regional areas or in some other way) or how management makes decisions about continuing or disposing of the enterprise's assets and operations. Appendix A, Example 1, gives examples of identification of a cash-generating unit.
69. ***If an active market exists for the output produced by an asset or a group of assets, this asset or group of assets should be identified as a cash-generating unit, even if some or all of the output is used internally. If this is the case, management's best estimate of future market prices for the output should be used:***
- (a) ***in determining the value in use of this cash-generating unit, when estimating the future cash inflows that relate to the internal use of the output; and***
 - (b) ***in determining the value in use of other cash-generating units of the reporting enterprise, when estimating the future cash outflows that relate to the internal use of the output.***
70. Even if part or all of the output produced by an asset or a group of assets is used by other units of the reporting enterprise (for example, products at an intermediate stage of a production process), this asset or group of assets forms a separate cash-generating unit if the enterprise could sell this output on an active market. This is because this asset or group of assets could generate cash inflows from continuing use that

would be largely independent of the cash inflows from other assets or groups of assets. In using information based on financial budgets/forecasts that relates to such a cash-generating unit, an enterprise adjusts this information if internal transfer prices do not reflect management's best estimate of future market prices for the cash-generating unit's output.

71. ***Cash-generating units should be identified consistently from period to period for the same asset or types of assets, unless a change is justified.***
72. If an enterprise determines that an asset belongs to a different cash-generating unit than in previous periods, or that the types of assets aggregated for the asset's cash-generating unit have changed, paragraph 117 requires certain disclosures about the cash-generating unit, if an impairment loss is recognised or reversed for the cash-generating unit and is material to the financial statements of the reporting enterprise as a whole.

Recoverable amount and carrying amount of a cash-generating unit

73. The recoverable amount of a cash-generating unit is the higher of the cash-generating unit's net selling price and value in use. For the purpose of determining the recoverable amount of a cash-generating unit, any reference in paragraphs 16 to 56 to 'an asset' is read as a reference to 'a cash-generating unit'.
74. ***The carrying amount of a cash-generating unit should be determined consistently with the way the recoverable amount of the cash-generating unit is determined.***
75. The carrying amount of a cash-generating unit:
- (a) includes the carrying amount of only those assets that can be attributed directly, or allocated on a reasonable and consistent basis, to the cash-generating unit and that will generate the future cash inflows estimated in determining the cash-generating unit's value in use; and
 - (b) does not include the carrying amount of any recognised liability, unless the recoverable amount of the cash-generating unit cannot be determined without consideration of this liability.

This is because net selling price and value in use of a cash-generating unit are determined excluding cash flows that relate to assets that are not part of the cash-generating unit and liabilities that have already been recognised in the financial statements (see paragraphs 24 and 36).

76. Where assets are grouped for recoverability assessments, it is important to include in the cash-generating unit all assets that generate the relevant stream of cash inflows from continuing use. Otherwise, the cash-generating unit may appear to be fully recoverable when in fact an impairment loss has occurred. In some cases, although certain assets contribute to the estimated future cash flows of a cash-generating unit, they cannot be allocated to the cash-generating unit on a reasonable and consistent basis. This might be the case for goodwill or corporate assets such as head office assets. Paragraphs 79 to 87 explain how to deal with these assets in testing a cash-generating unit for impairment.
77. It may be necessary to consider certain recognised liabilities in order to determine the recoverable amount of a cash-generating unit. This may occur if the disposal of a cash-generating unit would require the buyer to take over a liability. In this case, the net selling price (or the estimated cash flow from ultimate disposal) of the cash-generating unit is the estimated selling price for the assets of the cash-generating unit and the liability together, less the costs of disposal. In order to perform a meaningful comparison between the carrying amount of the cash-generating unit and its recoverable amount, the carrying amount of the liability is deducted in determining both the cash-generating unit's value in use and its carrying amount.

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Example

A company operates a mine in a country where legislation requires that the owner must restore the site on completion of its mining operations. The cost of restoration includes the replacement of the overburden, which must be removed before mining operations commence. A provision for the costs to replace the overburden was recognised as soon as the overburden was removed. The amount provided was recognised as part of the cost of the mine and is being depreciated over the mine's useful life. The carrying amount of the provision for restoration costs is 500, which is equal to the present value of the restoration costs.

The enterprise is testing the mine for impairment. The cash-generating unit for the mine is the mine as a whole. The enterprise has received various offers to buy the mine at a price of around 800; this price encompasses the fact that the buyer will take over the obligation to restore the overburden. Disposal costs for the mine are negligible. The value in use of the mine is approximately 1 200, excluding restoration costs. The carrying amount of the mine is 1 000.

The net selling price for the cash-generating unit is 800. This amount considers restoration costs that have already been provided for. As a consequence, the value in use for the cash-generating unit is determined after consideration of the restoration costs and is estimated to be 700 (1 200 less 500). The carrying amount of the cash-generating unit is 500, which is the carrying amount of the mine (1 000) less the carrying amount of the provision for restoration costs (500).

78. For practical reasons, the recoverable amount of a cash-generating unit is sometimes determined after consideration of assets that are not part of the cash-generating unit (for example, receivables or other financial assets) or liabilities that have already been recognised in the financial statements (for example, payables, pensions and other provisions). In such cases, the carrying amount of the cash-generating unit is increased by the carrying amount of those assets and decreased by the carrying amount of those liabilities.

Goodwill

79. Goodwill arising on acquisition represents a payment made by an 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. Goodwill does not generate cash flows independently from other assets or groups of assets and, therefore, the recoverable amount of goodwill as an individual asset cannot be determined. As a consequence, if there is an indication that goodwill may be impaired, recoverable amount is determined for the cash-generating unit to which goodwill belongs. This amount is then compared to the carrying amount of this cash-generating unit and any impairment loss is recognised in accordance with paragraph 88.
80. ***In testing a cash-generating unit for impairment, an enterprise should identify whether goodwill that relates to this cash-generating unit is recognised in the financial statements. If this is the case, an enterprise should:***
- (a) ***perform a 'bottom-up' test, that is, the enterprise should:***
 - (i) ***identify whether the carrying amount of goodwill can be allocated on a reasonable and consistent basis to the cash-generating unit under review; and***
 - (ii) ***then, compare the recoverable amount of the cash-generating unit under review to its carrying amount (including the carrying amount of allocated goodwill, if any) and recognise any impairment loss in accordance with paragraph 88.***

The enterprise should perform the second step of the 'bottom-up' test even if none of the carrying amount of goodwill can be allocated on a reasonable and consistent basis to the cash-generating unit under review; and

- (b) *if, in performing the 'bottom-up' test, the enterprise could not allocate the carrying amount of goodwill on a reasonable and consistent basis to the cash-generating unit under review, the enterprise should also perform a 'top-down' test, that is, the enterprise should:*
- (i) *identify the smallest cash-generating unit that includes the cash-generating unit under review and to which the carrying amount of goodwill can be allocated on a reasonable and consistent basis (the 'larger' cash-generating unit); and*
 - (ii) *then, compare the recoverable amount of the larger cash-generating unit to its carrying amount (including the carrying amount of allocated goodwill) and recognise any impairment loss in accordance with paragraph 88.*
81. Whenever a cash-generating unit is tested for impairment, an enterprise considers any goodwill that is associated with the future cash flows to be generated by the cash-generating unit. If goodwill can be allocated on a reasonable and consistent basis, an enterprise applies the 'bottom-up' test only. If it is not possible to allocate goodwill on a reasonable and consistent basis, an enterprise applies both the 'bottom-up' test and 'top-down' test (see Appendix A, Example 7).
82. The 'bottom-up' test ensures that an enterprise recognises any impairment loss that exists for a cash-generating unit, including for goodwill that can be allocated on a reasonable and consistent basis. Whenever it is impracticable to allocate goodwill on a reasonable and consistent basis in the 'bottom-up' test, the combination of the 'bottom-up' and the 'top-down' test ensures that an enterprise recognises:
- (a) first, any impairment loss that exists for the cash-generating unit excluding any consideration of goodwill; and
 - (b) then, any impairment loss that exists for goodwill. Because an enterprise applies the 'bottom-up' test first to all assets that may be impaired, any impairment loss identified for the larger cash-generating unit in the 'top-down' test relates only to goodwill allocated to the larger unit.
83. If the 'top-down' test is applied, an enterprise formally determines the recoverable amount of the larger cash-generating unit, unless there is persuasive evidence that there is no risk that the larger cash-generating unit is impaired (see paragraph 12).

Corporate assets

84. Corporate assets include group or divisional assets such as the building of a headquarters or a division of the enterprise, EDP equipment or a research centre. The structure of an enterprise determines whether an asset meets this Standard's definition of corporate assets for a particular cash-generating unit. Key characteristics of corporate assets are that they do not generate cash inflows independently from other assets or groups of assets and their carrying amount cannot be fully attributed to the cash-generating unit under review.
85. Because corporate assets do not generate separate cash inflows, the recoverable amount of an individual corporate asset cannot be determined unless management has decided to dispose of the asset. As a consequence, if there is an indication that a corporate asset may be impaired, recoverable amount is determined for the cash-generating unit to which the corporate asset belongs, compared to the carrying amount of this cash-generating unit and any impairment loss is recognised in accordance with paragraph 88.

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86. ***In testing a cash-generating unit for impairment, an enterprise should identify all the corporate assets that relate to the cash-generating unit under review. For each identified corporate asset, an enterprise should then apply paragraph 80, that is:***
- (a) ***if the carrying amount of the corporate asset can be allocated on a reasonable and consistent basis to the cash-generating unit under review, an enterprise should apply the 'bottom-up' test only; and***
 - (b) ***if the carrying amount of the corporate asset cannot be allocated on a reasonable and consistent basis to the cash-generating unit under review, an enterprise should apply both the 'bottom-up' and 'top-down' tests.***
87. An example of how to deal with corporate assets can be found in Appendix A, Example 8.

Impairment loss for a cash-generating unit

88. ***An impairment loss should be recognised for a cash-generating unit if, and only if, its recoverable amount is less than its carrying amount. The impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order:***
- (a) ***first, to goodwill allocated to the cash-generating unit (if any); and***
 - (b) ***then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.***
- These reductions in carrying amounts should be treated as impairment losses on individual assets and recognised in accordance with paragraph 59.***
89. ***In allocating an impairment loss under paragraph 88, the carrying amount of an asset should not be reduced below the highest of:***
- (a) ***its net selling price (if determinable);***
 - (b) ***its value in use (if determinable); and***
 - (c) ***zero.***

The amount of the impairment loss that would otherwise have been allocated to the asset should be allocated to the other assets of the unit on a pro-rata basis.

90. The goodwill allocated to a cash-generating unit is reduced before reducing the carrying amount of the other assets of the unit because of its nature.
91. If there is no practical way to estimate the recoverable amount of each individual asset of a cash-generating unit, this Standard requires an arbitrary allocation of an impairment loss between the assets of that unit, other than goodwill, because all assets of a cash-generating unit work together.
92. If the recoverable amount of an individual asset cannot be determined (see paragraph 66):
- (a) an impairment loss is recognised for the asset if its carrying amount is greater than the higher of its net selling price and the results of the allocation procedures described in paragraphs 88 and 89; and
 - (b) no impairment loss is recognised for the asset if the related cash-generating unit is not impaired. This applies even if the asset's net selling price is less than its carrying amount.

Example

A machine has suffered physical damage but is still working, although not as well as it used to. The net selling price of the machine is less than its carrying amount. The machine does not generate independent cash inflows from continuing use. The smallest identifiable group of assets that includes the machine and generates cash inflows from continuing use that are largely independent of the cash inflows from other assets is the production line to which the machine belongs. The recoverable amount of the production line shows that the production line taken as a whole is not impaired.

Assumption 1: budgets/forecasts approved by management reflect no commitment of management to replace the machine.

The recoverable amount of the machine alone cannot be estimated since the machine's value in use:

- (a) may differ from its net selling price; and
- (b) can be determined only for the cash-generating unit to which the machine belongs (the production line).

The production line is not impaired, therefore, no impairment loss is recognised for the machine. Nevertheless, the enterprise may need to reassess the depreciation period or the depreciation method for the machine. Perhaps, a shorter depreciation period or a faster depreciation method is required to reflect the expected remaining useful life of the machine or the pattern in which economic benefits are consumed by the enterprise.

Assumption 2: budgets/forecasts approved by management reflect a commitment of management to replace the machine and sell it in the near future. Cash flows from continuing use of the machine until its disposal are estimated to be negligible.

The machine's value in use can be estimated to be close to its net selling price. Therefore, the recoverable amount of the machine can be determined and no consideration is given to the cash-generating unit to which the machine belongs (the production line). Since the machine's net selling price is less than its carrying amount, an impairment loss is recognised for the machine.

93. ***After the requirements in paragraphs 88 and 89 have been applied, a liability should be recognised for any remaining amount of an impairment loss for a cash-generating unit if, and only if, that is required by other International Accounting Standards.***

REVERSAL OF AN IMPAIRMENT LOSS

94. Paragraphs 95 to 101 set out the requirements for reversing an impairment loss recognised for an asset or a cash-generating unit in prior years. These requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit. Additional requirements are set out for an individual asset in paragraphs 102 to 106, for a cash generating unit in paragraphs 107 to 108 and for goodwill in paragraphs 109 to 112.
95. ***An enterprise should assess at each balance sheet date whether there is any indication that an impairment loss recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the enterprise should estimate the recoverable amount of that asset.***
96. ***In assessing whether there is any indication that an impairment loss recognised for an asset in prior years may no longer exist or may have decreased, an enterprise should consider, as a minimum, the following indications:***

External sources of information

- (a) ***the asset's market value has increased significantly during the period;***
- (b) ***significant changes with a favourable effect on the enterprise have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the enterprise operates or in the market to which the asset is dedicated;***

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- (c) *market interest rates or other market rates of return on investments have decreased during the period, and those decreases are likely to affect the discount rate used in calculating the asset's value in use and increase the asset's recoverable amount materially;*

Internal sources of information

- (d) *significant changes with a favourable effect on the enterprise have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, the asset is used or is expected to be used. These changes include capital expenditure that has been incurred during the period to improve or enhance an asset in excess of its originally assessed standard of performance or a commitment to discontinue or restructure the operation to which the asset belongs; and*
- (e) *evidence is available from internal reporting that indicates that the economic performance of the asset is, or will be, better than expected.*
97. Indications of a potential decrease in an impairment loss in paragraph 96 mainly mirror the indications of a potential impairment loss in paragraph 9. The concept of materiality applies in identifying whether an impairment loss recognised for an asset in prior years may need to be reversed and the recoverable amount of the asset determined.
98. If there is an indication that an impairment loss recognised for an asset may no longer exist or may have decreased, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value may need to be reviewed and adjusted in accordance with the International Accounting Standard applicable to the asset, even if no impairment loss is reversed for the asset.
99. ***An impairment loss recognised for an asset in prior years should be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset should be increased to its recoverable amount. That increase is a reversal of an impairment loss.***
100. A reversal of an impairment loss reflects an increase in the estimated service potential of an asset, either from use or sale, since the date when an enterprise last recognised an impairment loss for that asset. An enterprise is required to identify the change in estimates that causes the increase in estimated service potential. Examples of changes in estimates include:
- (a) a change in the basis for recoverable amount (i.e., whether recoverable amount is based on net selling price or value in use);
- (b) if recoverable amount was based on value in use: a change in the amount or timing of estimated future cash flows or in the discount rate; or
- (c) if recoverable amount was based on net selling price: a change in estimate of the components of net selling price.
101. An asset's value in use may become greater than the asset's carrying amount simply because the present value of future cash inflows increases as they become closer. However, the service potential of the asset has not increased. Therefore, an impairment loss is not reversed just because of the passage of time (sometimes called the 'unwinding' of the discount), even if the recoverable amount of the asset becomes higher than its carrying amount.

Reversal of an impairment loss for an individual asset

102. ***The increased carrying amount of an asset due to a reversal of an impairment loss should not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.***

103. Any increase in the carrying amount of an asset above the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years is a revaluation. In accounting for such a revaluation, an enterprise applies the International Accounting Standard applicable to the asset.
104. ***A reversal of an impairment loss for an asset should be recognised as income immediately in the income statement, unless the asset is carried at revalued amount under another International Accounting Standard (for example, under the allowed alternative treatment in IAS 16, property, plant and equipment). Any reversal of an impairment loss on a revalued asset should be treated as a revaluation increase under that other International Accounting Standard.***
105. A reversal of an impairment loss on a revalued asset is credited directly to equity under the heading revaluation surplus. However, to the extent that an impairment loss on the same revalued asset was previously recognised as an expense in the income statement, a reversal of that impairment loss is recognised as income in the income statement.
106. ***After a reversal of an impairment loss is recognised, the depreciation (amortisation) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.***

Reversal of an impairment loss for a cash-generating unit

107. ***A reversal of an impairment loss for a cash-generating unit should be allocated to increase the carrying amount of the assets of the unit in the following order:***
- (a) ***first, assets other than goodwill on a pro-rata basis based on the carrying amount of each asset in the unit; and***
 - (b) ***then, to goodwill allocated to the cash-generating unit (if any), if the requirements in paragraph 109 are met.***

These increases in carrying amounts should be treated as reversals of impairment losses for individual assets and recognised in accordance with paragraph 104.

108. ***In allocating a reversal of an impairment loss for a cash-generating unit under paragraph 107, the carrying amount of an asset should not be increased above the lower of:***
- (a) ***its recoverable amount (if determinable); and***
 - (b) ***the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.***

The amount of the reversal of the impairment loss that would otherwise have been allocated to the asset should be allocated to the other assets of the unit on a pro-rata basis.

Reversal of an impairment loss for goodwill

109. ***As an exception to the requirement in paragraph 99, an impairment loss recognised for goodwill should not be reversed in a subsequent period unless:***
- (a) ***the impairment loss was caused by a specific external event of an exceptional nature that is not expected to recur; and***
 - (b) ***subsequent external events have occurred that reverse the effect of that event.***
110. IAS 38, intangible assets, prohibits the recognition of internally generated goodwill. Any subsequent increase in the recoverable amount of goodwill is likely to be an increase in internally generated goodwill, unless the increase relates clearly to the reversal of the effect of a specific external event of an exceptional nature.

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111. This Standard does not permit an impairment loss to be reversed for goodwill because of a change in estimates (for example, a change in the discount rate or in the amount and timing of future cash flows of the cash-generating unit to which goodwill relates).
112. A specific external event is an event that is outside of the control of the enterprise. Examples of external events of an exceptional nature include new regulations that significantly curtail the operating activities, or decrease the profitability, of the business to which the goodwill relates.

DISCLOSURE

113. **For each class of assets, the financial statements should disclose:**
- (a) **the amount of impairment losses recognised in the income statement during the period and the line item(s) of the income statement in which those impairment losses are included;**
 - (b) **the amount of reversals of impairment losses recognised in the income statement during the period and the line item(s) of the income statement in which those impairment losses are reversed;**
 - (c) **the amount of impairment losses recognised directly in equity during the period; and**
 - (d) **the amount of reversals of impairment losses recognised directly in equity during the period.**
114. A class of assets is a grouping of assets of similar nature and use in an enterprise's operations.
115. The information required in paragraph 113 may be presented with other information disclosed for the class of assets. For example, this information may be included in a reconciliation of the carrying amount of property, plant and equipment, at the beginning and end of the period, as required under IAS 16, property, plant and equipment.
116. **An enterprise that applies IAS 14, segment reporting, should disclose the following for each reportable segment based on an enterprise's primary format (as defined in IAS 14):**
- (a) **the amount of impairment losses recognised in the income statement and directly in equity during the period; and**
 - (b) **the amount of reversals of impairment losses recognised in the income statement and directly in equity during the period.**
117. **If an impairment loss for an individual asset or a cash-generating unit is recognised or reversed during the period and is material to the financial statements of the reporting enterprise as a whole, an enterprise should disclose:**
- (a) **the events and circumstances that led to the recognition or reversal of the impairment loss;**
 - (b) **the amount of the impairment loss recognised or reversed;**
 - (c) **for an individual asset:**
 - (i) **the nature of the asset; and**
 - (ii) **the reportable segment to which the asset belongs, based on the enterprise's primary format (as defined in IAS 14, segment reporting, if the enterprise applies IAS 14);**

- (d) *for a cash-generating unit:*
- (i) *a description of the cash-generating unit (such as whether it is a product line, a plant, a business operation, a geographical area, a reportable segment as defined in IAS 14 or other);*
 - (ii) *the amount of the impairment loss recognised or reversed by class of assets and by reportable segment based on the enterprise's primary format (as defined in IAS 14, if the enterprise applies IAS 14); and*
 - (iii) *if the aggregation of assets for identifying the cash-generating unit has changed since the previous estimate of the cash-generating unit's recoverable amount (if any), the enterprise should describe the current and former way of aggregating assets and the reasons for changing the way the cash-generating unit is identified;*
- (e) *whether the recoverable amount of the asset (cash-generating unit) is its net selling price or its value in use;*
- (f) *if recoverable amount is net selling price, the basis used to determine net selling price (such as whether selling price was determined by reference to an active market or in some other way); and*
- (g) *if recoverable amount is value in use, the discount rate(s) used in the current estimate and previous estimate (if any) of value in use.*
118. *If impairment losses recognised (reversed) during the period are material in aggregate to the financial statements of the reporting enterprise as a whole, an enterprise should disclose a brief description of the following:*
- (a) *the main classes of assets affected by impairment losses (reversals of impairment losses) for which no information is disclosed under paragraph 117; and*
 - (b) *the main events and circumstances that led to the recognition (reversal) of these impairment losses for which no information is disclosed under paragraph 117.*
119. An enterprise is encouraged to disclose key assumptions used to determine the recoverable amount of assets (cash-generating units) during the period.

TRANSITIONAL PROVISIONS

120. *This Standard should be applied on a prospective basis only. Impairment losses (reversals of impairment losses) that result from adoption of this International Accounting Standard should be recognised in accordance with this Standard (i.e., in the income statement unless an asset is carried at revalued amount. An impairment loss (reversal of impairment loss) on a revalued asset should be treated as a revaluation decrease (increase)).*
121. Before the adoption of this Standard, various International Accounting Standards included requirements broadly similar to those included in this Standard for the recognition and reversal of impairment losses. However, changes may arise from previous assessments because this Standard details how to measure recoverable amount and how to consider an asset's cash-generating unit. It would be difficult to determine retrospectively what the estimate of recoverable amount would have been. Therefore, on adoption of this Standard, an enterprise does not apply the benchmark or the allowed alternative treatment for other changes in accounting policies in IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies.

EFFECTIVE DATE

122. *This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 July 1999. Earlier application is encouraged. If an enterprise applies this Standard for financial statements covering periods beginning before 1 July 1999, the enterprise should disclose that fact.*

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INTERNATIONAL ACCOUNTING STANDARD IAS 37

Provisions, contingent liabilities and contingent assets

This International Accounting Standard was approved by the IASC Board in July 1998 and became effective for financial statements covering periods beginning on or after 1 July 1999.

INTRODUCTION

1. IAS 37 prescribes the accounting and disclosure for all provisions, contingent liabilities and contingent assets, except:
 - (a) those resulting from financial instruments that are carried at fair value;
 - (b) those resulting from executory contracts, except where the contract is onerous. Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent;
 - (c) those arising in insurance enterprises from contracts with policyholders; or
 - (d) those covered by another International Accounting Standard.

Provisions

2. The Standard defines provisions as liabilities of uncertain timing or amount. A provision should be recognised when, and only when:
 - (a) an enterprise has a present obligation (legal or constructive) as a result of a past event;
 - (b) it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation; and
 - (c) a reliable estimate can be made of the amount of the obligation. The Standard notes that it is only in extremely rare cases that a reliable estimate will not be possible.
3. The Standard defines a constructive obligation as an obligation that derives from an enterprise's actions where:
 - (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the enterprise has indicated to other parties that it will accept certain responsibilities; and
 - (b) as a result, the enterprise has created a valid expectation on the part of those other parties that it will discharge those responsibilities.
4. In rare cases, for example in a law suit, it may not be clear whether an enterprise has a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the balance sheet date. An enterprise recognises a provision for that present obligation if the other recognition criteria described above are met. If it is more likely than not that no present obligation exists, the enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote.
5. The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date, in other words, the amount that an enterprise would rationally pay to settle the obligation at the balance sheet date or to transfer it to a third party at that time.
6. The Standard requires that an enterprise should, in measuring a provision:
 - (a) take risks and uncertainties into account. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities;

- (b) discount the provisions, where the effect of the time value of money is material, using a pre-tax discount rate (or rates) that reflect(s) current market assessments of the time value of money and those risks specific to the liability that have not been reflected in the best estimate of the expenditure. Where discounting is used, the increase in the provision due to the passage of time is recognised as an interest expense;
 - (c) take future events, such as changes in the law and technological changes, into account where there is sufficient objective evidence that they will occur; and
 - (d) not take gains from the expected disposal of assets into account, even if the expected disposal is closely linked to the event giving rise to the provision.
7. An enterprise may expect reimbursement of some or all of the expenditure required to settle a provision (for example, through insurance contracts, indemnity clauses or suppliers' warranties). An enterprise should:
- (a) recognise a reimbursement when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The amount recognised for the reimbursement should not exceed the amount of the provision; and
 - (b) recognise the reimbursement as a separate asset. In the income statement, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.
8. Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.
9. A provision should be used only for expenditures for which the provision was originally recognised.

Provisions — specific applications

10. The Standard explains how the general recognition and measurement requirements for provisions should be applied in three specific cases: future operating losses; onerous contracts; and restructurings.
11. Provisions should not be recognised for future operating losses. An expectation of future operating losses is an indication that certain assets of the operation may be impaired. In this case, an enterprise tests these assets for impairment under IAS 36, impairment of assets.
12. If an enterprise has a contract that is onerous, the present obligation under the contract should be recognised and measured as a provision. An onerous contract is one in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.
13. The Standard defines a restructuring as a programme that is planned and controlled by management, and materially changes either:
- (a) the scope of a business undertaken by an enterprise; or
 - (b) the manner in which that business is conducted.
14. A provision for restructuring costs is recognised only when the general recognition criteria for provisions are met. In this context, a constructive obligation to restructure arises only when an enterprise:
- (a) has a detailed formal plan for the restructuring identifying at least:
 - (i) the business or part of a business concerned;
 - (ii) the principal locations affected;
 - (iii) the location, function, and approximate number of employees who will be compensated for terminating their services;

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- (iv) the expenditures that will be undertaken; and
 - (v) when the plan will be implemented; and
 - (b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.
15. A management or board decision to restructure does not give rise to a constructive obligation at the balance sheet date unless the enterprise has, before the balance sheet date:
- (a) started to implement the restructuring plan; or
 - (b) communicated the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the enterprise will carry out the restructuring.
16. Where a restructuring involves the sale of an operation, no obligation arises for the sale until the enterprise is committed to the sale, i.e. there is a binding sale agreement.
17. A restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both:
- (a) necessarily entailed by the restructuring; and
 - (b) not associated with the ongoing activities of the enterprise. Thus, a restructuring provision does not include such costs as: retraining or relocating continuing staff; marketing; or investment in new systems and distribution networks.

Contingent liabilities

18. The Standard supersedes the parts of IAS 10, contingencies and events occurring after the balance sheet date⁽¹⁾, that deal with contingencies. The Standard defines a contingent liability as:
- (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or
 - (b) a present obligation that arises from past events but is not recognised because:
 - (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - (ii) the amount of the obligation cannot be measured with sufficient reliability.
19. An enterprise should not recognise a contingent liability. An enterprise should disclose a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets

20. The Standard defines a contingent asset as a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain.
21. An enterprise should not recognise a contingent asset. A contingent asset should be disclosed where an inflow of economic benefits is probable.
22. When the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.

⁽¹⁾ IAS 10, contingencies and events occurring after the balance sheet date, was superseded by IAS 10 (revised 1999), events after the balance sheet date, effective 1 January 2000.

Effective date

23. The Standard becomes operative for annual financial statements covering periods beginning on or after 1 July 1999. Earlier application is encouraged.

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

OBJECTIVE

The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount.

SCOPE

1. ***This Standard should be applied by all enterprises in accounting for provisions, contingent liabilities and contingent assets, except:***
 - (a) ***those resulting from financial instruments that are carried at fair value;***
 - (b) ***those resulting from executory contracts, except where the contract is onerous;***
 - (c) ***those arising in insurance enterprises from contracts with policyholders; and***
 - (d) ***those covered by another International Accounting Standard.***
2. This Standard applies to financial instruments (including guarantees) that are not carried at fair value.
3. Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. This Standard does not apply to executory contracts unless they are onerous.
4. This Standard applies to provisions, contingent liabilities and contingent assets of insurance enterprises other than those arising from contracts with policyholders.
5. Where another International Accounting Standard deals with a specific type of provision, contingent liability or contingent asset, an enterprise applies that Standard instead of this Standard. For example, certain types of provisions are also addressed in Standards on:
 - (a) construction contracts (see IAS 11, construction contracts);
 - (b) income taxes (see IAS 12, income taxes);
 - (c) leases (see IAS 17, leases). However, as IAS 17 contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases; and
 - (d) employee benefits (see IAS 19, employee benefits).
6. Some amounts treated as provisions may relate to the recognition of revenue, for example where an enterprise gives guarantees in exchange for a fee. This Standard does not address the recognition of revenue. IAS 18, revenue, identifies the circumstances in which revenue is recognised and provides practical guidance on the application of the recognition criteria. This Standard does not change the requirements of IAS 18.
7. This Standard defines provisions as liabilities of uncertain timing or amount. In some countries the term 'provision' is also used in the context of items such as depreciation, impairment of assets and doubtful debts: these are adjustments to the carrying amounts of assets and are not addressed in this Standard.

8. Other International Accounting Standards specify whether expenditures are treated as assets or as expenses. These issues are not addressed in this Standard. Accordingly, this Standard neither prohibits nor requires capitalisation of the costs recognised when a provision is made.
9. This Standard applies to provisions for restructuring (including discontinuing operations). Where a restructuring meets the definition of a discontinuing operation, additional disclosures may be required by IAS 35, discontinuing operations.

DEFINITIONS

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

A provision is a liability of uncertain timing or amount.

A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

An obligating event is an event that creates a legal or constructive obligation that results in an enterprise having no realistic alternative to settling that obligation.

A legal obligation is an obligation that derives from:

- (a) *a contract (through its explicit or implicit terms);*
- (b) *legislation; or*
- (c) *other operation of law.*

A constructive obligation is an obligation that derives from an enterprise's actions where:

- (a) *by an established pattern of past practice, published policies or a sufficiently specific current statement, the enterprise has indicated to other parties that it will accept certain responsibilities; and*
- (b) *as a result, the enterprise has created a valid expectation on the part of those other parties that it will discharge those responsibilities.*

A contingent liability is:

- (a) *a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or*
- (b) *a present obligation that arises from past events but is not recognised because:*
 - (i) *it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or*
 - (ii) *the amount of the obligation cannot be measured with sufficient reliability.*

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

An onerous contract is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

A restructuring is a programme that is planned and controlled by management, and materially changes either:

- (a) *the scope of a business undertaken by an enterprise; or*
- (b) *the manner in which that business is conducted.*

IAS 37*Provisions and other liabilities*

11. Provisions can be distinguished from other liabilities such as trade payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:
- (a) trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier; and
 - (b) accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation pay). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

Accruals are often reported as part of trade and other payables, whereas provisions are reported separately.

Relationship between provisions and contingent liabilities

12. In a general sense, all provisions are contingent because they are uncertain in timing or amount. However, within this Standard the term 'contingent' is used for liabilities and assets that are not recognised because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise. In addition, the term 'contingent liability' is used for liabilities that do not meet the recognition criteria.
13. This Standard distinguishes between:
- (a) provisions — which are recognised as liabilities (assuming that a reliable estimate can be made) because they are present obligations and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations; and
 - (b) contingent liabilities — which are not recognised as liabilities because they are either:
 - (i) possible obligations, as it has yet to be confirmed whether the enterprise has a present obligation that could lead to an outflow of resources embodying economic benefits; or
 - (ii) present obligations that do not meet the recognition criteria in this Standard (because either it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made).

RECOGNITION*Provisions*

14. **A provision should be recognised when:**
- (a) **an enterprise has a present obligation (legal or constructive) as a result of a past event ⁽²⁾;**
 - (b) **it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and**
 - (c) **a reliable estimate can be made of the amount of the obligation.**

If these conditions are not met, no provision should be recognised.

⁽²⁾ See also SIC-6: costs of modifying existing software.

Present obligation

15. ***In rare cases it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the balance sheet date.***
16. In almost all cases it will be clear whether a past event has given rise to a present obligation. In rare cases, for example in a law suit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an enterprise determines whether a present obligation exists at the balance sheet date by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the balance sheet date. On the basis of such evidence:
- (a) where it is more likely than not that a present obligation exists at the balance sheet date, the enterprise recognises a provision (if the recognition criteria are met); and
 - (b) where it is more likely that no present obligation exists at the balance sheet date, the enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 86).

Past event

17. A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the enterprise has no realistic alternative to settling the obligation created by the event. This is the case only:
- (a) where the settlement of the obligation can be enforced by law; or
 - (b) in the case of a constructive obligation, where the event (which may be an action of the enterprise) creates valid expectations in other parties that the enterprise will discharge the obligation.
18. Financial statements deal with the financial position of an enterprise at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an enterprise's balance sheet are those that exist at the balance sheet date.
19. It is only those obligations arising from past events existing independently of an enterprise's future actions (i.e. the future conduct of its business) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the enterprise. Similarly, an enterprise recognises a provision for the decommissioning costs of an oil installation or a nuclear power station to the extent that the enterprise is obliged to rectify damage already caused. In contrast, because of commercial pressures or legal requirements, an enterprise may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the enterprise can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.
20. An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed — indeed the obligation may be to the public at large. Because an obligation always involves a commitment to another party, it follows that a management or board decision does not give rise to a constructive obligation at the balance sheet date unless the decision has been communicated before the balance sheet date to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the enterprise will discharge its responsibilities.

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21. An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law or because an act (for example, a sufficiently specific public statement) by the enterprise gives rise to a constructive obligation. For example, when environmental damage is caused there may be no obligation to remedy the consequences. However, the causing of the damage will become an obligating event when a new law requires the existing damage to be rectified or when the enterprise publicly accepts responsibility for rectification in a way that creates a constructive obligation.
22. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted as drafted. For the purpose of this Standard, such an obligation is treated as a legal obligation. Differences in circumstances surrounding enactment make it impossible to specify a single event that would make the enactment of a law virtually certain. In many cases it will be impossible to be virtually certain of the enactment of a law until it is enacted.

Probable outflow of resources embodying economic benefits

23. For a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. For the purpose of this Standard ⁽³⁾, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, i.e. the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 86).
24. Where there are a number of similar obligations (e.g. product warranties or similar contracts) the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of outflow for any one item may be small, it may well be probable that some outflow of resources will be needed to settle the class of obligations as a whole. If that is the case, a provision is recognised (if the other recognition criteria are met).

Reliable estimate of the obligation

25. The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature are more uncertain than most other balance sheet items. Except in extremely rare cases, an enterprise will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision.
26. In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability (see paragraph 86).

Contingent liabilities

27. ***An enterprise should not recognise a contingent liability.***
28. A contingent liability is disclosed, as required by paragraph 86, unless the possibility of an outflow of resources embodying economic benefits is remote.
29. Where an enterprise is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. The enterprise recognises a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable, except in the extremely rare circumstances where no reliable estimate can be made.
30. Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs (except in the extremely rare circumstances where no reliable estimate can be made).

⁽³⁾ The interpretation of 'probable' in this Standard as 'more likely than not' does not necessarily apply in other International Accounting Standards.

Contingent assets

31. ***An enterprise should not recognise a contingent asset.***
32. Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain.
33. Contingent assets are not recognised in financial statements since this may result in the recognition of income that may never be realised. However, when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.
34. A contingent asset is disclosed, as required by paragraph 89, where an inflow of economic benefits is probable.
35. Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an enterprise discloses the contingent asset (see paragraph 89).

MEASUREMENT

Best estimate

36. ***The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date.***
37. The best estimate of the expenditure required to settle the present obligation is the amount that an enterprise would rationally pay to settle the obligation at the balance sheet date or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the balance sheet date. However, the estimate of the amount that an enterprise would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the balance sheet date.
38. The estimates of outcome and financial effect are determined by the judgement of the management of the enterprise, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the balance sheet date.
39. Uncertainties surrounding the amount to be recognised as a provision are dealt with by various means according to the circumstances. Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities. The name for this statistical method of estimation is 'expected value'. The provision will therefore be different depending on whether the probability of a loss of a given amount is, for example, 60 % or 90 %. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.

Example

An enterprise sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defects that become apparent within the first six months after purchase. If minor defects were detected in all products sold, repair costs of 1 000 000 would result. If major defects were detected in all products sold, repair costs of 4 million would result. The enterprise's past experience and future expectations indicate that, for the coming year, 75 % of the goods sold will have no defects, 20 % of the goods sold will have minor defects and 5 % of the goods sold will have major defects. In accordance with paragraph 24, an enterprise assesses the probability of an outflow for the warranty obligations as a whole.

The expected value of the cost of repairs is:

$$(75 \% \text{ of nil}) + (20 \% \text{ of } 1\,000\,000) + (5 \% \text{ of } 4\,000\,000) = 400\,000$$

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40. Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the enterprise considers other possible outcomes. Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount. For example, if an enterprise has to rectify a serious fault in a major plant that it has constructed for a customer, the individual most likely outcome may be for the repair to succeed at the first attempt at a cost of 1 000, but a provision for a larger amount is made if there is a significant chance that further attempts will be necessary.
41. The provision is measured before tax, as the tax consequences of the provision, and changes in it, are dealt with under IAS 12, income taxes.

Risks and uncertainties

42. ***The risks and uncertainties that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a provision.***
43. Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgements under conditions of uncertainty, so that income or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.
44. Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph 85(b).

Present value

45. ***Where the effect of the time value of money is material, the amount of a provision should be the present value of the expenditure expected to be required to settle the obligation.***
46. Because of the time value of money, provisions relating to cash outflows that arise soon after the balance sheet date are more onerous than those where cash outflows of the same amount arise later. Provisions are therefore discounted, where the effect is material.
47. ***The discount rate (or rates) should be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted.***

Future events

48. ***Future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.***
49. Expected future events may be particularly important in measuring provisions. For example, an enterprise may believe that the cost of cleaning up a site at the end of its life will be reduced by future changes in technology. The amount recognised reflects a reasonable expectation of technically qualified, objective observers, taking account of all available evidence as to the technology that will be available at the time of the clean-up. Thus it is appropriate to include, for example, expected cost reductions associated with increased experience in applying existing technology or the expected cost of applying existing technology to a larger or more complex clean-up operation than has previously been carried out. However, an enterprise does not anticipate the development of a completely new technology for cleaning up unless it is supported by sufficient objective evidence.

50. The effect of possible new legislation is taken into consideration in measuring an existing obligation when sufficient objective evidence exists that the legislation is virtually certain to be enacted. The variety of circumstances that arise in practice makes it impossible to specify a single event that will provide sufficient, objective evidence in every case. Evidence is required both of what legislation will demand and of whether it is virtually certain to be enacted and implemented in due course. In many cases sufficient objective evidence will not exist until the new legislation is enacted.

Expected disposal of assets

51. ***Gains from the expected disposal of assets should not be taken into account in measuring a provision.***
52. Gains on the expected disposal of assets are not taken into account in measuring a provision, even if the expected disposal is closely linked to the event giving rise to the provision. Instead, an enterprise recognises gains on expected disposals of assets at the time specified by the International Accounting Standard dealing with the assets concerned.

REIMBURSEMENTS

53. ***Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.***
54. ***In the income statement, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.***
55. Sometimes, an enterprise is able to look to another party to pay part or all of the expenditure required to settle a provision (for example, through insurance contracts, indemnity clauses or suppliers' warranties). The other party may either reimburse amounts paid by the enterprise or pay the amounts directly.
56. In most cases the enterprise will remain liable for the whole of the amount in question so that the enterprise would have to settle the full amount if the third party failed to pay for any reason. In this situation, a provision is recognised for the full amount of the liability, and a separate asset for the expected reimbursement is recognised when it is virtually certain that reimbursement will be received if the enterprise settles the liability.
57. In some cases, the enterprise will not be liable for the costs in question if the third party fails to pay. In such a case the enterprise has no liability for those costs and they are not included in the provision.
58. As noted in paragraph 29, an obligation for which an enterprise is jointly and severally liable is a contingent liability to the extent that it is expected that the obligation will be settled by the other parties.

Changes in provisions

59. ***Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.***
60. Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognised as borrowing cost.

Use of provisions

61. ***A provision should be used only for expenditures for which the provision was originally recognised.***

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62. Only expenditures that relate to the original provision are set against it. Setting expenditures against a provision that was originally recognised for another purpose would conceal the impact of two different events.

APPLICATION OF THE RECOGNITION AND MEASUREMENT RULES

Future operating losses

63. ***Provisions should not be recognised for future operating losses.***
64. Future operating losses do not meet the definition of a liability in paragraph 10 and the general recognition criteria set out for provisions in paragraph 14.
65. An expectation of future operating losses is an indication that certain assets of the operation may be impaired. An enterprise tests these assets for impairment under IAS 36, impairment of assets.

Onerous contracts

66. ***If an enterprise has a contract that is onerous, the present obligation under the contract should be recognised and measured as a provision.***
67. Many contracts (for example, some routine purchase orders) can be cancelled without paying compensation to the other party, and therefore there is no obligation. Other contracts establish both rights and obligations for each of the contracting parties. Where events make such a contract onerous, the contract falls within the scope of this Standard and a liability exists which is recognised. Executory contracts that are not onerous fall outside the scope of this Standard.
68. This Standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.
69. Before a separate provision for an onerous contract is established, an enterprise recognises any impairment loss that has occurred on assets dedicated to that contract (see IAS 36, impairment of assets).

Restructuring

70. The following are examples of events that may fall under the definition of restructuring:
- (a) sale or termination of a line of business;
 - (b) the closure of business locations in a country or region or the relocation of business activities from one country or region to another;
 - (c) changes in management structure, for example, eliminating a layer of management; and
 - (d) fundamental reorganisations that have a material effect on the nature and focus of the enterprise's operations.
71. A provision for restructuring costs is recognised only when the general recognition criteria for provisions set out in paragraph 14 are met. Paragraphs 72 to 83 set out how the general recognition criteria apply to restructurings.

72. ***A constructive obligation to restructure arises only when an enterprise:***
- (a) ***has a detailed formal plan for the restructuring identifying at least:***
 - (i) ***the business or part of a business concerned;***
 - (ii) ***the principal locations affected;***
 - (iii) ***the location, function, and approximate number of employees who will be compensated for terminating their services;***
 - (iv) ***the expenditures that will be undertaken; and***
 - (v) ***when the plan will be implemented; and***
 - (b) ***has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.***
73. Evidence that an enterprise has started to implement a restructuring plan would be provided, for example, by dismantling plant or selling assets or by the public announcement of the main features of the plan. A public announcement of a detailed plan to restructure constitutes a constructive obligation to restructure only if it is made in such a way and in sufficient detail (i.e. setting out the main features of the plan) that it gives rise to valid expectations in other parties such as customers, suppliers and employees (or their representatives) that the enterprise will carry out the restructuring.
74. For a plan to be sufficient to give rise to a constructive obligation when communicated to those affected by it, its implementation needs to be planned to begin as soon as possible and to be completed in a timeframe that makes significant changes to the plan unlikely. If it is expected that there will be a long delay before the restructuring begins or that the restructuring will take an unreasonably long time, it is unlikely that the plan will raise a valid expectation on the part of others that the enterprise is at present committed to restructuring, because the timeframe allows opportunities for the enterprise to change its plans.
75. A management or board decision to restructure taken before the balance sheet date does not give rise to a constructive obligation at the balance sheet date unless the enterprise has, before the balance sheet date:
- (a) started to implement the restructuring plan; or
 - (b) announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the enterprise will carry out the restructuring.
- In some cases, an enterprise starts to implement a restructuring plan, or announces its main features to those affected, only after the balance sheet date. Disclosure may be required under IAS 10, events after the balance sheet date, if the restructuring is of such importance that its non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.
76. Although a constructive obligation is not created solely by a management decision, an obligation may result from other earlier events together with such a decision. For example, negotiations with employee representatives for termination payments, or with purchasers for the sale of an operation, may have been concluded subject only to board approval. Once that approval has been obtained and communicated to the other parties, the enterprise has a constructive obligation to restructure, if the conditions of paragraph 72 are met.
77. In some countries, the ultimate authority is vested in a board whose membership includes representatives of interests other than those of management (e.g. employees) or notification to such representatives may be necessary before the board decision is taken. Because a decision by such a board involves communication to these representatives, it may result in a constructive obligation to restructure.

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78. ***No obligation arises for the sale of an operation until the enterprise is committed to the sale, i.e. there is a binding sale agreement.***
79. Even when an enterprise has taken a decision to sell an operation and announced that decision publicly, it cannot be committed to the sale until a purchaser has been identified and there is a binding sale agreement. Until there is a binding sale agreement, the enterprise will be able to change its mind and indeed will have to take another course of action if a purchaser cannot be found on acceptable terms. When the sale of an operation is envisaged as part of a restructuring, the assets of the operation are reviewed for impairment, under IAS 36, impairment of assets. When a sale is only part of a restructuring, a constructive obligation can arise for the other parts of the restructuring before a binding sale agreement exists.
80. ***A restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both:***
- (a) ***necessarily entailed by the restructuring; and***
 - (b) ***not associated with the ongoing activities of the enterprise.***
81. A restructuring provision does not include such costs as:
- (a) retraining or relocating continuing staff;
 - (b) marketing; or
 - (c) investment in new systems and distribution networks.
- These expenditures relate to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognised on the same basis as if they arose independently of a restructuring.
82. Identifiable future operating losses up to the date of a restructuring are not included in a provision, unless they relate to an onerous contract as defined in paragraph 10.
83. As required by paragraph 51, gains on the expected disposal of assets are not taken into account in measuring a restructuring provision, even if the sale of assets is envisaged as part of the restructuring.

DISCLOSURE

84. ***For each class of provision, an enterprise should disclose:***
- (a) ***the carrying amount at the beginning and end of the period;***
 - (b) ***additional provisions made in the period, including increases to existing provisions;***
 - (c) ***amounts used (i.e. incurred and charged against the provision) during the period;***
 - (d) ***unused amounts reversed during the period; and***
 - (e) ***the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.***
- Comparative information is not required.***
85. ***An enterprise should disclose the following for each class of provision:***
- (a) ***a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;***

- (b) *an indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an enterprise should disclose the major assumptions made concerning future events, as addressed in paragraph 48; and*
- (c) *the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.*
86. *Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:*
- (a) *an estimate of its financial effect, measured under paragraphs 36 to 52;*
- (b) *an indication of the uncertainties relating to the amount or timing of any outflow; and*
- (c) *the possibility of any reimbursement.*
87. In determining which provisions or contingent liabilities may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single statement about them to fulfil the requirements of paragraphs 85(a) and (b) and 86(a) and (b). Thus, it may be appropriate to treat as a single class of provision amounts relating to warranties of different products, but it would not be appropriate to treat as a single class amounts relating to normal warranties and amounts that are subject to legal proceedings.
88. Where a provision and a contingent liability arise from the same set of circumstances, an enterprise makes the disclosures required by paragraphs 84 to 86 in a way that shows the link between the provision and the contingent liability.
89. *Where an inflow of economic benefits is probable, an enterprise should disclose a brief description of the nature of the contingent assets at the balance sheet date, and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs 36 to 52.*
90. It is important that disclosures for contingent assets avoid giving misleading indications of the likelihood of income arising.
91. *Where any of the information required by paragraphs 86 and 89 is not disclosed because it is not practicable to do so, that fact should be stated.*
92. *In extremely rare cases, disclosure of some or all of the information required by paragraphs 84 to 89 can be expected to prejudice seriously the position of the enterprise in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an enterprise need not disclose the information, but should disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.*

Transitional provisions

93. *The effect of adopting this Standard on its effective date (or earlier) should be reported as an adjustment to the opening balance of retained earnings for the period in which the Standard is first adopted. Enterprises are encouraged, but not required, to adjust the opening balance of retained earnings for the earliest period presented and to restate comparative information. If comparative information is not restated, this fact should be disclosed.*
94. The Standard requires a different treatment from IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies. IAS 8 requires comparative information to be restated (benchmark treatment) or additional pro forma comparative information on a restated basis to be disclosed (allowed alternative treatment) unless it is impracticable to do so.

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EFFECTIVE DATE

95. *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 periods beginning before 1 July 1999, it should disclose that fact.*
96. This Standard supersedes the parts of IAS 10, contingencies and events occurring after the balance sheet date⁽⁴⁾, that deal with contingencies.

INTERNATIONAL ACCOUNTING STANDARD IAS 38**Intangible assets**

This International Accounting Standard was approved by the IASC Board in July 1998 and became effective for financial statements covering periods beginning on or after 1 July 1999.

This Standard supersedes:

- (a) IAS 4, depreciation accounting, with respect to the amortisation (depreciation) of intangible assets; and
- (b) IAS 9, research and development costs.

In October 1998, the IASC staff published separately a 'Basis for conclusions for IAS 38, intangible assets and IAS 22 (revised 1998)'. Copies are available from IASC's Publications Department.

In 1998, IAS 39, financial instruments: recognition and measurement, amended paragraph 2(f) of IAS 38 to replace the reference to IAS 25, accounting for investments, by reference to IAS 39. Footnote 1 was also deleted.

One SIC interpretation relates to IAS 38:

- SIC-6: costs of modifying existing software,
- SIC-32: Intangible assets — Web site costs.

INTRODUCTION

1. IAS 38 prescribes the accounting and disclosure for intangible assets that are not specifically dealt with in other International Accounting Standards. IAS 38 does not apply to financial assets, mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources and intangible assets arising in insurance enterprises from contracts with policyholders. IAS 38 applies, among other things, to expenditure on advertising, training, start-up, research and development activities.
2. An intangible asset is an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. An asset is a resource:
 - (a) controlled by an enterprise as a result of past events; and
 - (b) from which future economic benefits are expected to flow to the enterprise.

⁽⁴⁾ IAS 10: contingencies and events occurring after the balance sheet date, was superseded by IAS 10 (revised 1999), events after the balance sheet date, effective 1 January 2000.

3. IAS 38 requires an enterprise to recognise an intangible asset (at cost) if, and only if:
- (a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
 - (b) the cost of the asset can be measured reliably.

This requirement applies whether an intangible asset is acquired externally or generated internally. IAS 38 includes additional recognition criteria for internally generated intangible assets.

4. IAS 38 specifies that internally generated goodwill, brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as assets.
5. If an intangible item does not meet both the definition and the criteria for the recognition of an intangible asset, IAS 38 requires the expenditure on this item to be recognised as an expense when it is incurred. However, if the item is acquired in a business combination that is an acquisition, this expenditure (included in the cost of acquisition) should form part of the amount attributed to goodwill (negative goodwill) at the date of acquisition.
6. IAS 38 requires all expenditure on research to be recognised as an expense when it is incurred. Examples of other expenditure that will not give rise to an intangible asset that can be recognised in the financial statements are as follows:
- (a) expenditure on starting up an operation or a business (start-up costs);
 - (b) expenditure on training;
 - (c) expenditure on advertising and/or promotion; and
 - (d) expenditure on relocating or reorganising part or all of an enterprise.

Expenditure on these items is recognised as an expense when it is incurred.

7. IAS 38 requires that subsequent expenditure on an intangible asset after its purchase or completion should be recognised as an expense when it is incurred unless:
- (a) it is probable that this expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and
 - (b) the expenditure can be measured and attributed to the asset reliably.

If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

8. If expenditure on an intangible item was initially recognised as an expense by a reporting enterprise in previous annual financial statements or interim financial reports, IAS 38 prohibits the enterprise from recognising this expenditure as part of the cost of an intangible asset at a later date.
9. After initial recognition, IAS 38 requires an intangible asset to be measured under one of the following two treatments:
- (a) benchmark treatment: cost less any accumulated amortisation and any accumulated impairment losses; or
 - (b) allowed alternative treatment: revalued amount less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. The revalued amount should be the fair value of the asset. However, this treatment is permitted if, and only if, fair value can be determined by reference to an active market for the intangible asset. In addition, once an enterprise elects this treatment, IAS 38

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requires revaluations to be made with sufficient regularity such that the carrying amount of the intangible asset does not differ materially from that which would be determined using fair value at the balance sheet date. IAS 38 also specifies how intangible assets should be revalued and whether a revaluation increase (decrease) should be recognised in the income statement or directly in equity.

10. IAS 38 requires that an intangible asset should be amortised on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed 20 years from the date when the asset is available for use. IAS 38 does not permit an enterprise to assign an infinite useful life to an intangible asset. Amortisation should commence when the asset is available for use.
11. In rare cases, there may be persuasive evidence that the useful life of an intangible asset will be a specific period longer than 20 years. In these cases, IAS 38 requires an enterprise:
 - (a) to amortise the intangible asset over the best estimate of its useful life;
 - (b) to estimate the recoverable amount of the intangible asset at least annually to identify whether there is any impairment loss; and
 - (c) to disclose the reasons why the presumption that the useful life of an intangible asset will not exceed 20 years is rebutted and the factor(s) that played a significant role in determining the useful life of the intangible asset.
12. IAS 38 requires that the amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be adopted. The amortisation charge should be recognised as an expense unless another International Accounting Standard permits or requires it to be included in the carrying amount of another asset.
13. IAS 38 requires the residual value of an intangible asset to be assumed to be zero unless:
 - (a) there is a commitment by a third party to purchase the asset at the end of its useful life; or
 - (b) there is an active market for that type of asset and it is probable that such a market will exist at the end of the asset's useful life.
14. To assess whether an intangible asset may be impaired, an enterprise applies IAS 36, impairment of assets. Also, IAS 38 requires an enterprise to estimate the recoverable amount of an intangible asset that is not yet available for use at least annually.
15. IAS 38 is effective for accounting periods beginning on or after 1 July 1999. Earlier application is encouraged.
16. On first application, IAS 38 includes transitional provisions that require retrospective application:
 - (a) whenever this is necessary to eliminate an item that no longer qualifies for recognition under IAS 38; or
 - (b) if the previous measurement of an intangible asset contradicted the principles set out in IAS 38 (for example, if an intangible asset was not amortised or was revalued but not by reference to an active market).

In other cases, prospective application of the recognition and amortisation requirements is either required (for example, IAS 38 prohibits the recognition of an internally generated intangible asset that was not previously recognised) or permitted (for example, IAS 38 encourages the recognition of an intangible asset that was acquired in a business combination that was an acquisition and that was not previously recognised).

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

OBJECTIVE

The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another International Accounting Standard. This Standard requires an enterprise to recognise an intangible asset if, and only if, certain criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets and requires certain disclosures about intangible assets.

SCOPE

1. ***This Standard should be applied by all enterprises in accounting for intangible assets, except:***
 - (a) ***intangible assets that are covered by another International Accounting Standard;***
 - (b) ***financial assets, as defined in IAS 32, financial instruments: disclosure and presentation;***
 - (c) ***mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources; and***
 - (d) ***intangible assets arising in insurance enterprises from contracts with policyholders.***
2. If another International Accounting Standard deals with a specific type of intangible asset, an enterprise applies that Standard instead of this Standard. For example, this Standard does not apply to:
 - (a) intangible assets held by an enterprise for sale in the ordinary course of business (see IAS 2, inventories, and IAS 11, construction contracts);
 - (b) deferred tax assets (see IAS 12, income taxes);
 - (c) leases that fall within the scope of IAS 17, leases;
 - (d) assets arising from employee benefits (see IAS 19, employee benefits);

- (e) goodwill arising on a business combination (see IAS 22, business combinations); and
- (f) financial assets as defined in IAS 32, financial instruments: disclosure and presentation. The recognition and measurement of some financial assets are covered by: IAS 27, consolidated financial statements and accounting for investments in subsidiaries; IAS 28, accounting for investments in associates; IAS 31, financial reporting of interests in joint ventures; and IAS 39, financial instruments: recognition and measurement.
3. Some intangible assets may be contained in or on a physical substance such as a compact disk (in the case of computer software), legal documentation (in the case of a licence or patent) or film. In determining whether an asset that incorporates both intangible and tangible elements should be treated under IAS 16, property, plant and equipment, or as an intangible asset under this Standard, judgement is required to assess which element is more significant. For example, computer software for a computer controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as property, plant and equipment. The same applies to the operating system of a computer. Where the software is not an integral part of the related hardware, computer software is treated as an intangible asset.
4. This Standard applies to, among other things, expenditure on advertising, training, start-up, research and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (for example, a prototype), the physical element of the asset is secondary to its intangible component, that is the knowledge embodied in it.
5. In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee deals with an intangible asset held under a finance lease under this Standard. Rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights are excluded from the scope of IAS 17 and fall within the scope of this Standard.
6. Exclusions from the scope of an International Accounting Standard may occur if certain activities or transactions are so specialised that they give rise to accounting issues that may need to be dealt with in a different way. Such issues arise in the expenditure on the exploration for, or development and extraction of, oil, gas and mineral deposits in extractive industries and in the case of contracts between insurance enterprises and their policyholders. Therefore, this Standard does not apply to expenditure on such activities. However, this Standard applies to other intangible assets used (such as computer software), and other expenditure (such as start-up costs), in extractive industries or by insurance companies.

DEFINITIONS

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

An intangible asset is an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

An asset is a resource:

- (a) ***controlled by an enterprise as a result of past events; and***
- (b) ***from which future economic benefits are expected to flow to the enterprise.***

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

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

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Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

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

Useful life is either:

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

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

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

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

An active market is a market where all the following conditions exist:

- (a) ***the items traded within the market are homogeneous;***
- (b) ***willing buyers and sellers can normally be found at any time; and***
- (c) ***prices are available to the public.***

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

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

Intangible assets

8. Enterprises frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licences, intellectual property, market knowledge and trade marks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights.
9. Not all the items described in paragraph 8 will meet the definition of an intangible asset, that is, identifiability, control over a resource and existence of future economic benefits. If an item covered by this Standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in a business combination that is an acquisition, it forms part of the goodwill recognised at the date of acquisition (see paragraph 56).

Identifiability

10. The definition of an intangible asset requires that an intangible asset be identifiable to distinguish it clearly from goodwill. Goodwill arising on a business combination that is an 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.
11. An intangible asset can be clearly distinguished from goodwill if the asset is separable. An asset is separable if the enterprise could rent, sell, exchange or distribute the specific future economic benefits attributable to the asset without also disposing of future economic benefits that flow from other assets used in the same revenue earning activity.
12. Separability is not a necessary condition for identifiability since an enterprise may be able to identify an asset in some other way. For example, if an intangible asset is acquired with a group of assets, the transaction may involve the transfer of legal rights that enable an enterprise to identify the intangible asset. Similarly, if an internal project aims to create legal rights for the enterprise, the nature of these rights may assist the enterprise in identifying an underlying internally generated intangible asset. Also, even if an asset generates future economic benefits only in combination with other assets, the asset is identifiable if the enterprise can identify the future economic benefits that will flow from the asset.

Control

13. An enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. The capacity of an enterprise to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control since an enterprise may be able to control the future economic benefits in some other way.
14. Market and technical knowledge may give rise to future economic benefits. An enterprise controls those benefits if, for example, the knowledge is protected by legal rights such as copyrights, a restraint of trade agreement (where permitted) or by a legal duty on employees to maintain confidentiality.
15. An enterprise may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training. The enterprise may also expect that the staff will continue to make their skills available to the enterprise. However, usually an enterprise has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training to consider that these items meet the definition of an intangible asset. For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.
16. An enterprise may have a portfolio of customers or a market share and expect that, due to its efforts in building customer relationships and loyalty, the customers will continue to trade with the enterprise. However, in the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty of the customers to the enterprise, the enterprise usually has insufficient control over the economic benefits from customer relationships and loyalty to consider that such items (portfolio of customers, market shares, customer relationships, customer loyalty) meet the definition of intangible assets.

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Future economic benefits

17. The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the enterprise. For example, the use of intellectual property in a production process may reduce future production costs rather than increase future revenues.

RECOGNITION AND INITIAL MEASUREMENT OF AN INTANGIBLE ASSET

18. The recognition of an item as an intangible asset requires an enterprise to demonstrate that the item meets the:
- (a) definition of an intangible asset (see paragraphs 7 to 17); and
 - (b) recognition criteria set out in this Standard (see paragraphs 19 to 55).
19. ***An intangible asset should be recognised if, and only if:***
- (a) ***it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and***
 - (b) ***the cost of the asset can be measured reliably.***
20. ***An enterprise should assess the probability of future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.***
21. An enterprise uses judgement to assess the degree of certainty attached to the flow of future economic benefits that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence.
22. ***An intangible asset should be measured initially at cost.***

Separate acquisition

23. If an intangible asset is acquired separately, the cost of the intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.
24. The cost of an intangible asset comprises its purchase price, including any import duties and non-refundable purchase taxes, and any directly attributable expenditure on preparing the asset for its intended use. Directly attributable expenditure includes, for example, professional fees for legal services. Any trade discounts and rebates are deducted in arriving at the cost.
25. If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent; the difference between this amount and the total payments is recognised as interest expense over the period of credit unless it is capitalised under the allowed alternative treatment in IAS 23, borrowing costs.
26. If an intangible asset is acquired in exchange for equity instruments of the reporting enterprise, the cost of the asset is the fair value of the equity instruments issued, which is equal to the fair value of the asset.

Acquisition as part of a business combination

27. Under IAS 22 (revised 1998), business combinations, if an intangible asset is acquired in a business combination that is an acquisition, the cost of that intangible asset is based on its fair value at the date of acquisition.
28. Judgement is required to determine whether the cost (i.e. fair value) of an intangible asset acquired in a business combination can be measured with sufficient reliability for the purpose of separate recognition. Quoted market prices in an active market provide the most reliable measurement of fair value (see also paragraph 67). The appropriate market price is usually the current bid price. If current bid prices are unavailable, the price of the most recent similar transaction may provide a basis from which to estimate fair value, provided that there has not been a significant change in economic circumstances between the transaction date and the date at which the asset's fair value is estimated.
29. If no active market exists for an asset, its cost reflects the amount that the enterprise would have paid, at the date of the acquisition, for the asset in an arm's length transaction between knowledgeable and willing parties, based on the best information available. In determining this amount, an enterprise considers the outcome of recent transactions for similar assets.
30. Certain enterprises that are regularly involved in the purchase and sale of unique intangible assets have developed techniques for estimating their fair values indirectly. These techniques may be used for initial measurement of an intangible asset acquired in a business combination that is an acquisition if their objective is to estimate fair value as defined in this Standard and if they reflect current transactions and practices in the industry to which the asset belongs. These techniques include, where appropriate, applying multiples reflecting current market transactions to certain indicators driving the profitability of the asset (such as revenue, market shares, operating profit, etc.) or discounting estimated future net cash flows from the asset.
31. In accordance with this Standard and the requirements in IAS 22 (revised 1998) for the recognition of identifiable assets and liabilities:
 - (a) an acquirer recognises an intangible asset that meets the recognition criteria in paragraphs 19 and 20, even if that intangible asset had not been recognised in the financial statements of the acquiree; and
 - (b) if the cost (i.e. fair value) of an intangible asset acquired as part of a business combination that is an acquisition cannot be measured reliably, that asset is not recognised as a separate intangible asset but is included in goodwill (see paragraph 56).
32. Unless there is an active market for an intangible asset acquired in a business combination that is an acquisition, IAS 22 (revised 1998) limits the cost initially recognised for the intangible asset to an amount that does not create or increase any negative goodwill arising at the date of acquisition.

Acquisition by way of a government grant

33. In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant. This may occur when a government transfers or allocates to an enterprise intangible assets such as airport landing rights, licences to operate radio or television stations, import licences or quotas or rights to access other restricted resources. Under IAS 20, accounting for government grants and disclosure of government assistance, an enterprise may choose to recognise both the intangible asset and the grant at fair value initially. If an enterprise chooses not to recognise the asset initially at fair value, the enterprise recognises the asset initially at a nominal amount (under the other treatment permitted by IAS 20) plus any expenditure that is directly attributable to preparing the asset for its intended use.

IAS 38*Exchanges of assets*

34. An intangible asset may be acquired in exchange or part exchange for a dissimilar intangible asset or other asset. The cost of such an item is measured at the fair value of the asset received, which is equivalent to the fair value of the asset given up, adjusted by the amount of any cash or cash equivalents transferred.
35. An intangible asset may be acquired in exchange for a similar asset that has a similar use in the same line of business and that has a similar fair value. An intangible asset may also be sold in exchange for an equity interest in a similar asset. In both cases, since the earnings process is incomplete, no gain or loss is recognised on the transaction. Instead, the cost of the new asset is the carrying amount of the asset given up. However, the fair value of the asset received may provide evidence of an impairment loss in the asset given up. Under these circumstances an impairment loss is recognised for the asset given up and the carrying amount after impairment is assigned to the new asset.

Internally generated goodwill

36. ***Internally generated goodwill should not be recognised as an asset.***
37. In some cases, expenditure is incurred to generate future economic benefits, but it does not result in the creation of an intangible asset that meets the recognition criteria in this Standard. Such expenditure is often described as contributing to internally generated goodwill. Internally generated goodwill is not recognised as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.
38. Differences between the market value of an enterprise and the carrying amount of its identifiable net assets at any point in time may capture a range of factors that affect the value of the enterprise. However, such differences cannot be considered to represent the cost of intangible assets controlled by the enterprise.

Internally generated intangible assets

39. It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition. It is often difficult:
- (a) to identify whether, and the point of time when, there is an identifiable asset that will generate probable future economic benefits; and
 - (b) to determine the cost of the asset reliably. In some cases, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the enterprise's internally generated goodwill or of running day-to-day operations.

Therefore, in addition to complying with the general requirements for the recognition and initial measurement of an intangible asset, an enterprise applies the requirements and guidance in paragraphs 40-55 below to all internally generated intangible assets.

40. To assess whether an internally generated intangible asset meets the criteria for recognition, an enterprise classifies the generation of the asset into:
- (a) a research phase; and
 - (b) a development phase.

Although the terms 'research' and 'development' are defined, the terms 'research phase' and 'development phase' have a broader meaning for the purpose of this Standard.

41. If an enterprise cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the enterprise treats the expenditure on that project as if it were incurred in the research phase only.

Research phase

42. ***No intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred.***
43. This Standard takes the view that, in the research phase of a project, an enterprise cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Therefore, this expenditure is always recognised as an expense when it is incurred.
44. Examples of research activities are:
- (a) activities aimed at obtaining new knowledge;
 - (b) the search for, evaluation and final selection of, applications of research findings or other knowledge;
 - (c) the search for alternatives for materials, devices, products, processes, systems or services; and
 - (d) the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

Development phase

45. ***An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the following:***
- (a) ***the technical feasibility of completing the intangible asset so that it will be available for use or sale;***
 - (b) ***its intention to complete the intangible asset and use or sell it;***
 - (c) ***its ability to use or sell the intangible asset;***
 - (d) ***how the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;***
 - (e) ***the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and***
 - (f) ***its ability to measure the expenditure attributable to the intangible asset during its development reliably.***
46. In the development phase of a project, an enterprise can, in some instances, identify an intangible asset and demonstrate that the asset will generate probable future economic benefits. This is because the development phase of a project is further advanced than the research phase.
47. Examples of development activities are:
- (a) the design, construction and testing of pre-production or pre-use prototypes and models;
 - (b) the design of tools, jigs, moulds and dies involving new technology;
 - (c) the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and
 - (d) the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

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48. To demonstrate how an intangible asset will generate probable future economic benefits, an enterprise assesses the future economic benefits to be received from the asset using the principles in IAS 36, impairment of assets. If the asset will generate economic benefits only in combination with other assets, the enterprise applies the concept of cash-generating units as set out in IAS 36.
49. Availability of resources to complete, use and obtain the benefits from an intangible asset can be demonstrated by, for example, a business plan showing the technical, financial and other resources needed and the enterprise's ability to secure those resources. In certain cases, an enterprise demonstrates the availability of external finance by obtaining a lender's indication of its willingness to fund the plan.
50. An enterprise's costing systems can often measure reliably the cost of generating an intangible asset internally, such as salary and other expenditure incurred in securing copyrights or licences or developing computer software.
51. ***Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as intangible assets.***
52. This Standard takes the view that expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

Cost of an internally generated intangible asset

53. The cost of an internally generated intangible asset for the purpose of paragraph 22 is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraphs 19-20 and 45. Paragraph 59 prohibits reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports.
54. The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and preparing the asset for its intended use. The cost includes, if applicable:
 - (a) expenditure on materials and services used or consumed in generating the intangible asset;
 - (b) the salaries, wages and other employment related costs of personnel directly engaged in generating the asset;
 - (c) any expenditure that is directly attributable to generating the asset, such as fees to register a legal right and the amortisation of patents and licences that are used to generate the asset; and
 - (d) overheads that are necessary to generate the asset and that can be allocated on a reasonable and consistent basis to the asset (for example, an allocation of the depreciation of property, plant and equipment, insurance premiums and rent). Allocations of overheads are made on bases similar to those used in allocating overheads to inventories (see IAS 2, inventories). IAS 23, borrowing costs, establishes criteria for the recognition of interest as a component of the cost of an internally generated intangible asset.
55. The following are not components of the cost of an internally generated intangible asset:
 - (a) selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to preparing the asset for use;
 - (b) clearly identified inefficiencies and initial operating losses incurred before an asset achieves planned performance; and
 - (c) expenditure on training staff to operate the asset.

Example illustrating paragraph 53

An enterprise is developing a new production process. During 20X5, expenditure incurred was 1 000, of which 900 was incurred before 1 December 20X5 and 100 was incurred between 1 December 20X5 and 31 December 20X5. The enterprise is able to demonstrate that, at 1 December 20X5, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be 500.

At the end of 20X5, the production process is recognised as an intangible asset at a cost of 100 (expenditure incurred since the date when the recognition criteria were met, that is, 1 December 20X5). The 900 expenditure incurred before 1 December 20X5 is recognised as an expense because the recognition criteria were not met until 1 December 20X5. This expenditure will never form part of the cost of the production process recognised in the balance sheet.

During 20X6, expenditure incurred is 2 000. At the end of 20X6, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be 1 900.

At the end of 20X6, the cost of the production process is 2 100 (100 expenditure recognised at the end of 20X5 plus 2 000 expenditure recognised in 20X6). The enterprise recognises an impairment loss of 200 to adjust the carrying amount of the process before impairment loss (2 100) to its recoverable amount (1 900). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in IAS 36, impairment of assets, are met.

RECOGNITION OF AN EXPENSE

56. ***Expenditure on an intangible item should be recognised as an expense when it is incurred unless:***
- (a) ***it forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs 18 to 55); or***
 - (b) ***the item is acquired in a business combination that is an acquisition and cannot be recognised as an intangible asset. If this is the case, this expenditure (included in the cost of acquisition) should form part of the amount attributed to goodwill (negative goodwill) at the date of acquisition (see IAS 22 (revised 1998), business combinations).***
57. In some cases, expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. For example, expenditure on research is always recognised as an expense when it is incurred (see paragraph 42). Examples of other expenditure that is recognised as an expense when it is incurred include:
- (a) expenditure on start-up activities (start-up costs), unless this expenditure is included in the cost of an item of property, plant and equipment under IAS 16. Start-up costs may consist of establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or business (pre-opening costs) or expenditures for commencing new operations or launching new products or processes (pre-operating costs);
 - (b) expenditure on training activities;
 - (c) expenditure on advertising and promotional activities; and
 - (d) expenditure on relocating or reorganising part or all of an enterprise.
58. Paragraph 56 does not preclude recognising a prepayment as an asset when payment for the delivery of goods or services has been made in advance of the delivery of goods or the rendering of services.

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Past expenses not to be recognised as an asset

59. ***Expenditure on an intangible item that was initially recognised as an expense by a reporting enterprise in previous annual financial statements or interim financial reports should not be recognised as part of the cost of an intangible asset at a later date.***

SUBSEQUENT EXPENDITURE

60. ***Subsequent expenditure on an intangible asset after its purchase or its completion should be recognised as an expense when it is incurred unless:***
- (a) ***it is probable that this expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and***
 - (b) ***this expenditure can be measured and attributed to the asset reliably.***

If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset⁽¹⁾.

61. Subsequent expenditure on a recognised intangible asset is recognised as an expense if this expenditure is required to maintain the asset at its originally assessed standard of performance. The nature of intangible assets is such that, in many cases, it is not possible to determine whether subsequent expenditure is likely to enhance or maintain the economic benefits that will flow to the enterprise from those assets. In addition, it is often difficult to attribute such expenditure directly to a particular intangible asset rather than the business as a whole. Therefore, only rarely will expenditure incurred after the initial recognition of a purchased intangible asset or after completion of an internally generated intangible asset result in additions to the cost of the intangible asset.
62. Consistent with paragraph 51, subsequent expenditure on brands, mastheads, publishing titles, customer lists and items similar in substance (whether externally purchased or internally generated) is always recognised as an expense to avoid the recognition of internally generated goodwill.

MEASUREMENT SUBSEQUENT TO INITIAL RECOGNITION

Benchmark treatment

63. ***After initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses.***

Allowed alternative treatment

64. ***After initial recognition, an intangible asset should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. For the purpose of revaluations under this Standard, fair value should be determined by reference to an active market. Revaluations should be made with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.***
65. The allowed alternative treatment does not allow:
- (a) the revaluation of intangible assets that have not previously been recognised as assets; or
 - (b) the initial recognition of intangible assets at amounts other than their cost.

⁽¹⁾ See also SIC-6: cost of modifying existing software.

66. The allowed alternative treatment is applied after an asset has been initially recognised at cost. However, if only part of the cost of an intangible asset is recognised as an asset because the asset did not meet the criteria for recognition until part of the way through the process (see paragraph 53), the allowed alternative may be applied to the whole of that asset. Also, the allowed alternative treatment may be applied to an intangible asset that was received by way of a government grant and recognised at a nominal amount (see paragraph 33).
67. It is uncommon for an active market with the characteristics described in paragraph 7 to exist for an intangible asset, although this may occur. For example, in certain jurisdictions, an active market may exist for freely-transferable taxi licences, fishing licences or production quotas. However, an active market cannot exist for brands, newspaper mastheads, music and film publishing rights, patents or trade marks, because each such asset is unique. Also, although intangible assets are bought and sold, contracts are negotiated between individual buyers and sellers, and transactions are relatively infrequent. For these reasons, the price paid for one asset may not provide sufficient evidence of the fair value of another. Finally, prices are often not available to the public.
68. The frequency of revaluations depends on the volatility of the fair values of the intangible assets being revalued. If the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some intangible assets may experience significant and volatile movements in fair value thus necessitating annual revaluation. Such frequent revaluations are unnecessary for intangible assets with only insignificant movements in fair value.
69. If an intangible asset is revalued, any accumulated amortisation at the date of the revaluation is either:
- (a) restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount; or
 - (b) eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset.
70. ***If an intangible asset is revalued, all the other assets in its class should also be revalued, unless there is no active market for those assets.***
71. A class of intangible assets is a grouping of assets of a similar nature and use in an enterprise's operations. The items within a class of intangible assets are revalued simultaneously in order to avoid selective revaluation of assets and the reporting of amounts in the financial statements representing a mixture of costs and values as at different dates.
72. ***If an intangible asset in a class of revalued intangible assets cannot be revalued because there is no active market for this asset, the asset should be carried at its cost less any accumulated amortisation and impairment losses.***
73. ***If the fair value of a revalued intangible asset can no longer be determined by reference to an active market, the carrying amount of the asset should be its revalued amount at the date of the last revaluation by reference to the active market less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.***
74. The fact that an active market no longer exists for a revalued intangible asset may indicate that the asset may be impaired and that it needs to be tested under IAS 36, impairment of assets.
75. If the fair value of the asset can be determined by reference to an active market at a subsequent measurement date, the allowed alternative treatment is applied from that date.

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76. ***If an intangible asset's carrying amount is increased as a result of a revaluation, the increase should be credited directly to equity under the heading of revaluation surplus. However, a revaluation increase should be recognised as income to the extent that it reverses a revaluation decrease of the same asset and that revaluation decrease was previously recognised as an expense.***
77. ***If an asset's carrying amount is decreased as a result of a revaluation, the decrease should be recognised as an expense. However, a revaluation decrease should be charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation surplus in respect of that same asset.***
78. The cumulative revaluation surplus included in equity may be transferred directly to retained earnings when the surplus is realised. The whole surplus may be realised on the retirement or disposal of the asset. However, some of the surplus may be realised as the asset is used by the enterprise; in such a case, the amount of the surplus realised is the difference between amortisation based on the revalued carrying amount of the asset and amortisation that would have been recognised based on the asset's historical cost. The transfer from revaluation surplus to retained earnings is not made through the income statement.

AMORTISATION

Amortisation Period

79. ***The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed 20 years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.***
80. As the future economic benefits embodied in an intangible asset are consumed over time, the carrying amount of the asset is reduced to reflect that consumption. This is achieved by systematic allocation of the cost or revalued amount of the asset, less any residual value, as an expense over the asset's useful life. Amortisation is recognised whether or not there has been an increase in, for example, the asset's fair value or recoverable amount. Many factors need to be considered in determining the useful life of an intangible asset including:
- (a) the expected usage of the asset by the enterprise and whether the asset could be efficiently managed by another management team;
 - (b) typical product life cycles for the asset and public information on estimates of useful lives of similar types of assets that are used in a similar way;
 - (c) technical, technological or other types of obsolescence;
 - (d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;
 - (e) expected actions by competitors or potential competitors;
 - (f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the company's ability and intent to reach such a level;
 - (g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and
 - (h) whether the useful life of the asset is dependent on the useful life of other assets of the enterprise.

81. Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it is likely that their useful life will be short.
82. Estimates of the useful life of an intangible asset generally become less reliable as the length of the useful life increases. This Standard adopts a presumption that the useful life of intangible assets is unlikely to exceed 20 years.
83. In rare cases, there may be persuasive evidence that the useful life of an intangible asset will be a specific period longer than 20 years. In these cases, the presumption that the useful life generally does not exceed 20 years is rebutted and the enterprise:
- (a) amortises the intangible asset over the best estimate of its useful life;
 - (b) estimates the recoverable amount of the intangible asset at least annually in order to identify any impairment loss (see paragraph 99); 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 asset (see paragraph 111(a)).

Examples

- A. An enterprise has purchased an exclusive right to generate hydro-electric power for 60 years. The costs of generating hydro-electric power are much lower than the costs of obtaining power from alternative sources. It is expected that the geographical area surrounding the power station will demand a significant amount of power from the power station for at least 60 years.
- The enterprise amortises the right to generate power over 60 years, unless there is evidence that its useful life is shorter.
- B. An enterprise has purchased an exclusive right to operate a toll motorway for 30 years. There is no plan to construct alternative routes in the area served by the motorway. It is expected that this motorway will be in use for at least 30 years.
- The enterprise amortises the right to operate the motorway over 30 years, unless there is evidence that its useful life is shorter.
84. The useful life of an intangible asset may be very long but it is always finite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically short.
85. ***If control over the future economic benefits from an intangible asset is achieved through legal rights that have been granted for a finite period, the useful life of the intangible asset should not exceed the period of the legal rights unless:***
- (a) ***the legal rights are renewable; and***
 - (b) ***renewal is virtually certain.***
86. There may be both economic and legal factors influencing the useful life of an intangible asset: economic factors determine the period over which future economic benefits will be received; legal factors may restrict the period over which the enterprise controls access to these benefits. The useful life is the shorter of the periods determined by these factors.
87. The following factors, among others, indicate that renewal of a legal right is virtually certain:
- (a) the fair value of the intangible asset does not reduce as the initial expiry date approaches, or does not reduce by more than the cost of renewing the underlying right;

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- (b) there is evidence (possibly based on past experience) that the legal rights will be renewed; and
- (c) there is evidence that the conditions necessary to obtain the renewal of the legal right (if any) will be satisfied.

Amortisation method

88. ***The amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used. The amortisation charge for each period should be recognised as an expense unless another International Accounting Standard permits or requires it to be included in the carrying amount of another asset.***
89. A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the unit of production method. The method used for an asset is selected based on the expected pattern of consumption of economic benefits and is consistently applied from period to period, unless there is a change in the expected pattern of consumption of economic benefits to be derived from that asset. There will rarely, if ever, be persuasive evidence to support an amortisation method for intangible assets that results in a lower amount of accumulated amortisation than under the straight-line method.
90. Amortisation is usually recognised as an expense. However, sometimes, the economic benefits embodied in an asset are absorbed by the enterprise in producing other assets rather than giving rise to an expense. In these cases, the amortisation charge forms part of the cost of the other asset and is included in its carrying amount. For example, the amortisation of intangible assets used in a production process is included in the carrying amount of inventories (see IAS 2, inventories).

Residual Value

91. ***The residual value of an intangible asset should be assumed to be zero unless:***
- (a) ***there is a commitment by a third party to purchase the asset at the end of its useful life; or***
 - (b) ***there is an active market for the asset and:***
 - (i) ***residual value can be determined by reference to that market; and***
 - (ii) ***it is probable that such a market will exist at the end of the asset's useful life.***
92. The depreciable amount of an asset is determined after deducting its residual value. A residual value other than zero implies that an enterprise expects to dispose of the intangible asset before the end of its economic life.
93. If the benchmark treatment is adopted, the residual value is estimated using prices prevailing at the date of acquisition of the asset, for the sale of a similar asset that has reached the end of its estimated useful life and that has operated under conditions similar to those in which the asset will be used. The residual value is not subsequently increased for changes in prices or value. If the allowed alternative treatment is adopted, a new estimate of residual value is made at the date of each revaluation of the asset using prices prevailing at that date.

Review of amortisation period and amortisation method

94. ***The amortisation period and the amortisation method should be reviewed at least at each financial year end. If the expected useful life of the asset 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 the asset, the amortisation 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.***

95. During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. For example, the useful life may be extended by subsequent expenditure that improves the condition of the asset beyond its originally assessed standard of performance. Also, the recognition of an impairment loss may indicate that the amortisation period needs to be changed.
96. Over time, the pattern of future economic benefits expected to flow to an enterprise from an intangible asset may change. For example, it may become apparent that a diminishing balance method of amortisation is appropriate rather than a straight-line method. Another example is if use of the rights represented by a licence is deferred pending action on other components of the business plan. In this case, economic benefits that flow from the asset may not be received until later periods.

RECOVERABILITY OF THE CARRYING AMOUNT — IMPAIRMENT LOSSES

97. To determine whether an intangible asset is impaired, an enterprise applies IAS 36, impairment of assets. That Standard explains how an enterprise reviews the carrying amount of its assets, how it determines the recoverable amount of an asset and when it recognises or reverses an impairment loss.
98. Under IAS 22 (revised 1998), business combinations, if an impairment loss occurs before the end of the first annual accounting period commencing after acquisition for an intangible asset acquired in a business combination that was an acquisition, the impairment loss is recognised as an adjustment to both the amount assigned to the intangible asset and the goodwill (negative goodwill) recognised at the date of acquisition. However, if the impairment loss relates to specific events or changes in circumstances occurring after the date of acquisition, the impairment loss is recognised under IAS 36 and not as an adjustment to the amount assigned to the goodwill (negative goodwill) recognised at the date of acquisition.
99. ***In addition to following the requirements included in IAS 36, impairment of assets, an enterprise should estimate the recoverable amount of the following intangible assets at least at each financial year end, even if there is no indication that the asset is impaired:***
- (a) ***an intangible asset that is not yet available for use; and***
 - (b) ***an intangible asset that is amortised over a period exceeding 20 years from the date when the asset is available for use.***

The recoverable amount should be determined under IAS 36 and impairment losses recognised accordingly.

100. The ability of an intangible asset to generate sufficient future economic benefits to recover its cost is usually subject to great uncertainty until the asset is available for use. Therefore, this Standard requires an enterprise to test for impairment, at least annually, the carrying amount of an intangible asset that is not yet available for use.
101. It is sometimes difficult to identify whether an intangible asset may be impaired because, among other things, there is not necessarily any obvious evidence of obsolescence. This difficulty arises particularly if the asset has a long useful life. As a consequence, this Standard requires, as a minimum, an annual calculation of the recoverable amount of an intangible asset if its useful life exceeds 20 years from the date when it becomes available for use.
102. The requirement for an annual impairment test of an intangible asset applies whenever the current total estimated useful life of the asset exceeds 20 years from when it became available for use. Therefore, if the useful life of an intangible asset was estimated to be less than 20 years at initial recognition, but the useful life is extended by subsequent expenditure to exceed 20 years from when the asset became available for use, an enterprise performs the impairment test required under paragraph 99(b) and also makes the disclosure required under paragraph 111(a).

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RETIREMENTS AND DISPOSALS

103. *An intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.*
104. *Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the income statement.*
105. If an intangible asset is exchanged for a similar asset under the circumstances described in paragraph 35, the cost of the acquired asset is equal to the carrying amount of the asset disposed of and no gain or loss results.
106. An intangible asset that is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use. At least at each financial year end, an enterprise tests the asset for impairment under IAS 36, impairment of assets, and recognises any impairment loss accordingly.

DISCLOSURE

General

107. *The financial statements should disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:*
- (a) *the useful lives or the amortisation rates used;*
 - (b) *the amortisation methods used;*
 - (c) *the gross carrying amount and the accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period;*
 - (d) *the line item(s) of the income statement in which the amortisation of intangible assets is included;*
 - (e) *a reconciliation of the carrying amount at the beginning and end of the period showing:*
 - (i) *additions, indicating separately those from internal development and through business combinations;*
 - (ii) *retirements and disposals;*
 - (iii) *increases or decreases during the period resulting from revaluations under paragraphs 64, 76 and 77 and from impairment losses recognised or reversed directly in equity under IAS 36, impairment of assets (if any);*
 - (iv) *impairment losses recognised in the income statement during the period under IAS 36 (if any);*
 - (v) *impairment losses reversed in the income statement during the period under IAS 36 (if any);*
 - (vi) *amortisation recognised during the period;*
 - (vii) *net exchange differences arising on the translation of the financial statements of a foreign entity; and*
 - (viii) *other changes in the carrying amount during the period.*

Comparative information is not required.

108. A class of intangible assets is a grouping of assets of a similar nature and use in an enterprise's operations. Examples of separate classes may include:
- (a) brand names;
 - (b) mastheads and publishing titles;
 - (c) computer software;
 - (d) licences and franchises;
 - (e) copyrights, patents and other industrial property rights, service and operating rights;
 - (f) recipes, formulae, models, designs and prototypes; and
 - (g) intangible assets under development.
- The classes mentioned above are disaggregated (aggregated) into smaller (larger) classes if this results in more relevant information for the users of the financial statements.
109. An enterprise discloses information on impaired intangible assets under IAS 36 in addition to the information required by paragraph 107(e)(iii) to (v).
110. An enterprise discloses the nature and effect of a change in an accounting estimate that has a material effect in the current period or that is expected to have a material effect in subsequent periods, under IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policy. Such disclosure may arise from changes in:
- (a) the amortisation period;
 - (b) the amortisation method; or
 - (c) residual values.
111. **The financial statements should also disclose:**
- (a) **if an intangible asset is amortised over more than 20 years, the reasons why the presumption that the useful life of an intangible asset will not exceed 20 years from the date when the asset is available for use 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 asset;**
 - (b) **a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the financial statements of the enterprise as a whole;**
 - (c) **for intangible assets acquired by way of a government grant and initially recognised at fair value (see paragraph 33):**
 - (i) **the fair value initially recognised for these assets;**
 - (ii) **their carrying amount; and**
 - (iii) **whether they are carried under the benchmark or the allowed alternative treatment for subsequent measurement;**
 - (d) **the existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities; and**
 - (e) **the amount of commitments for the acquisition of intangible assets.**
112. When an enterprise describes the factor(s) that played a significant role in determining the useful life of an intangible asset that is amortised over more than 20 years, the enterprise considers the list of factors in paragraph 80.

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Intangible assets carried under the allowed alternative treatment

113. ***If intangible assets are carried at revalued amounts, the following should be disclosed:***

(a) ***by class of intangible assets:***

(i) ***the effective date of the revaluation;***

(ii) ***the carrying amount of revalued intangible assets; and***

(iii) ***the carrying amount that would have been included in the financial statements had the revalued intangible assets been carried under the benchmark treatment in paragraph 63; and***

(b) ***the amount of the revaluation surplus that relates to intangible assets at the beginning and end of the period, indicating the changes during the period and any restrictions on the distribution of the balance to shareholders.***

114. It may be necessary to aggregate the classes of revalued assets into larger classes for disclosure purposes. However, classes are not aggregated if this would result in the combination of a class of intangible assets that includes amounts measured under both benchmark and allowed alternative treatments for subsequent measurement.

Research and development expenditure

115. ***The financial statements should disclose the aggregate amount of research and development expenditure recognised as an expense during the period.***

116. Research and development expenditure comprises all expenditure that is directly attributable to research or development activities or that can be allocated on a reasonable and consistent basis to such activities (see paragraphs 54 to 55 for guidance on the type of expenditure to be included for the purpose of the disclosure requirement in paragraph 115).

Other information

117. An enterprise is encouraged, but not required, to give the following information:

(a) a description of any fully amortised intangible asset that is still in use; and

(b) a brief description of significant intangible assets controlled by the enterprise but not recognised as assets because they did not meet the recognition criteria in this Standard or because they were acquired or generated before this Standard was effective.

TRANSITIONAL PROVISIONS

118. ***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 these tables, this Standard should be applied retrospectively, unless it is impracticable to do so.***

119. The tables below require retrospective application whenever this is necessary to eliminate an item that no longer qualifies for recognition under this Standard or if the previous measurement of an intangible asset contradicted the principles set out in this Standard (for example, intangible assets that have never been amortised or that have been revalued but not by reference to an active market). In other cases, prospective application of the recognition and amortisation requirements is required or, in some cases, permitted.

120. *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).*
121. *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 — Recognition

Circumstances	Requirements
1. An intangible item was recognised as a separate asset — whether or not described as an intangible asset — and, at the effective date of this Standard (or at the date of adoption of this Standard, if earlier), the item does not meet the definition of, or recognition criteria for, an intangible asset.	
(a) The item was acquired in a business combination that was an acquisition.	(i) Reallocate the item to the goodwill (negative goodwill) resulting from the same acquisition; and (ii) adjust the goodwill (negative goodwill) recognised at the date of acquisition retrospectively, as if the item had always been included in the goodwill (negative goodwill) recognised at the date of acquisition. For example, if the goodwill was recognised as an asset and amortised, estimate the accumulated amortisation that would have been recognised, had the item been included in the goodwill recognised at the date of acquisition, and adjust the carrying amount of the goodwill accordingly.
(b) The item was not acquired in a business combination that was an acquisition (for example, it was purchased separately or generated internally).	Derecognise the item (eliminate it from the balance sheet).
2. An intangible item was recognised as a separate asset — whether or not described as an intangible asset — and, at the effective date of this Standard (or at the date of adoption of this Standard, if earlier), the item meets the definition of, and recognition criteria for, an intangible asset.	
(a) The asset was recognised initially at cost.	Classify the asset as an intangible asset. The cost initially recognised for the asset is deemed to have been properly determined. See transitional provisions for subsequent measurement and amortisation under circumstances 4 and 5 below.
(b) The asset was recognised initially at an amount other than cost.	(i) Classify the asset as an intangible asset; and (ii) re-estimate the carrying amount of the asset at cost (or revalued amount, after initial recognition at cost) less accumulated amortisation, determined under this Standard.
	If the cost of the intangible asset cannot be determined, derecognise the asset (eliminate it from the balance sheet).

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3. At the effective date of this Standard (or at the date of adoption of this Standard, if earlier), an item meets the definition of, and recognition criteria for, an intangible asset but it was not previously recognised as an asset.
- | | | |
|-----|---|--|
| (a) | The intangible asset was acquired in a business combination that was an acquisition and formed part of the goodwill recognised. | Recognition of the intangible asset is encouraged, but not required. If the intangible asset is recognised: |
| | | (i) measure the carrying amount of the asset at cost (or revalued amount) less accumulated amortisation determined under this Standard; and |
| | | (ii) adjust the goodwill recognised at the date of acquisition retrospectively, as if the intangible asset had never been included in the goodwill recognised at the date of acquisition. For example, if the goodwill was recognised as an asset and amortised, estimate the effect on the accumulated amortisation of the goodwill of distinguishing the intangible asset separately and adjust the carrying amount of the goodwill accordingly. |
| (b) | The intangible asset was not acquired in a business combination that was an acquisition (for example, it was purchased separately or generated internally). | The intangible asset should not be recognised. |

Transitional Provisions — Amortisation of an intangible asset carried under the benchmark treatment

- | Circumstances | Requirements |
|--|--|
| 4. The asset was not previously amortised or the amortisation charge was deemed to be nil. | Restate the carrying amount of the asset as if the accumulated amortisation had always been determined under this Standard. |
| 5. The asset was previously amortised. Accumulated amortisation determined under this Standard is different to that previously determined (because the amortisation period and/or the amortisation method is different). | Do not restate the carrying amount of the intangible asset for any difference between the accumulated amortisation in prior years and that calculated under this Standard. Amortise any carrying amount of the asset over its remaining useful life determined under this Standard (i.e. any change is treated as a change in accounting estimate — see paragraph 94). |

Transitional Provisions — Revalued intangible asset

- | Circumstances | Requirements |
|--|--|
| 6. An intangible asset was carried at a revalued amount not determined by reference to an active market: | |
| (a) There is an active market for the asset. | The asset should be revalued by reference to this active market at the effective date of this Standard (or at the date of adoption of this Standard, if earlier). |
| (b) There is no active market for the asset. | (i) Eliminate the effect of any revaluation; and
(ii) measure the carrying amount of the asset at cost less accumulated amortisation, determined under this Standard. |

EFFECTIVE DATE

122. *This International Accounting Standard becomes operative for annual financial statements covering periods beginning on or after 1 July 1999. Earlier application is encouraged. If an enterprise applies this Standard for annual financial statements covering periods beginning before 1 July 1999, the enterprise should:*
- (a) *disclose that fact; and*
 - (b) *adopt IAS 22 (revised 1998), business combinations, and IAS 36, impairment of assets, at the same time.*
123. This Standard supersedes:
- (a) IAS 4, depreciation accounting, with respect to the amortisation (depreciation) of intangible assets; and
 - (b) IAS 9, research and development costs.

INTERNATIONAL ACCOUNTING STANDARD IAS 40

Investment property

This International Accounting Standard was approved by the IASC Board in March 2000 and became effective for financial statements covering periods beginning on or after 1 January 2001.

This Standard supersedes IAS 25, Accounting for Investments, with respect to accounting for investment property. IAS 25 was withdrawn when this Standard came into effect.

In January 2001, IAS 41, agriculture, amended paragraph 3. The amended text is operative for annual financial statements covering periods beginning on or after 1 January 2003.

INTRODUCTION

1. IAS 40 prescribes the accounting treatment for investment property and related disclosure requirements. The Standard is effective for annual financial statements covering periods beginning on or after 1 January 2001. Earlier application is encouraged.
2. The Standard replaces previous requirements in IAS 25, accounting for investments. Under IAS 25, an enterprise was permitted to choose from among a variety of accounting treatments for investment property (depreciated cost under the benchmark treatment in IAS 16, property, plant and equipment, revaluation with depreciation under the allowed alternative treatment in IAS 16, cost less impairment under IAS 25 or revaluation under IAS 25). IAS 25 is withdrawn when this Standard comes into effect.
3. Investment property is defined as property (land or a building — or part of a building — or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:
 - (a) use in the production or supply of goods or services or for administrative purposes; or
 - (b) sale in the ordinary course of business.

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4. The Standard does not deal with:
 - (a) owner-occupied property (that is, property held for use in the production or supply of goods or services or for administrative purposes) — carried under IAS 16, property, plant and equipment, at either depreciated cost or revalued amount less subsequent depreciation;
 - (b) property held for sale in the ordinary course of business — carried at the lower of cost and net realisable value under IAS 2, inventories;
 - (c) property being constructed or developed for future use as investment property — IAS 16 applies to such property until the construction or development is complete, at which time the property becomes investment property and this Standard applies. However, this Standard does apply to existing investment property that is being redeveloped for continued future use as investment property;
 - (d) an interest held by a lessee under an operating lease — covered by IAS 17, leases;
 - (e) biological assets attached to land related to agricultural activity — covered by IAS 41, agriculture; and
 - (f) mineral rights, the exploration for and development of minerals, oil, natural gas and similar non-regenerative natural resources.
5. The Standard permits enterprises to choose either:
 - (a) a fair value model: investment property should be measured at fair value and changes in fair value should be recognised in the income statement; or
 - (b) a cost model. The cost model is the benchmark treatment in IAS 16, property, plant and equipment: investment property should be measured at depreciated cost (less any accumulated impairment losses). An enterprise that chooses the cost model should disclose the fair value of its investment property.
6. The fair value model differs from the revaluation model that the Board already permits for certain non-financial assets. Under the revaluation model, increases in carrying amount above a cost-based measure are recognised as revaluation surplus. However, under the fair value model, all changes in fair value are recognised in the income statement.
7. This is the first time that the Board has introduced a fair value accounting model for non-financial assets. The comment letters on Exposure Draft E64 showed that although many support this step, many others still have significant conceptual and practical reservations about extending a fair value model to non-financial assets. Also, some believe that certain property markets are not yet sufficiently mature for a fair value model to work satisfactorily. Furthermore, some believe that it is impossible to create a rigorous definition of investment property and that this makes it impracticable to require a fair value model at present.
8. For those reasons, the Board believes that it is impracticable, at this stage, to require a fair value model for investment property. At the same time, the Board believes that it is desirable to permit a fair value model. This evolutionary step forward will allow preparers and users to gain greater experience working with a fair value model and will allow time for certain property markets to achieve greater maturity.

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9. The Standard requires that an enterprise should apply the model chosen to all its investment property. A change from one model to the other model should be made only if the change will result in a more appropriate presentation. The Standard states that this is highly unlikely to be the case for a change from the fair value model to the cost model.
10. In exceptional cases, there is clear evidence when an enterprise first acquires an investment property (or when an existing property first becomes investment property following the completion of construction or development, or after a change in use) that the enterprise will not be able to determine the fair value of the investment property reliably on a continuing basis. In such cases, the Standard requires an enterprise to measure that investment property using the benchmark treatment in IAS 16 until the disposal of the investment property. The residual value of the investment property should be assumed to be zero. An enterprise that has chosen the fair value model measures all its other investment property at fair value.
11. Appendix A is a decision tree that summarises how an enterprise determines whether it applies IAS 40 (for investment property), rather than IAS 16, property, plant and equipment (for owner-occupied property or property that is being constructed or developed for future use as investment property), or IAS 2, inventories (for property held for sale in the ordinary course of business).
12. Appendix B, Basis for conclusions, summarises the Board's reasons for adopting the requirements set out in IAS 40.

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

OBJECTIVE

The objective of this Standard is to prescribe the accounting treatment for investment property and related disclosure requirements.

SCOPE

- This Standard should be applied in the recognition, measurement and disclosure of investment property.***
- Among other things, this Standard deals with the measurement in a lessee's financial statements of investment property held under a finance lease and with the measurement in a lessor's financial statements of investment property leased out under an operating lease. This Standard does not deal with matters covered in IAS 17, leases, including:
 - classification of leases as finance leases or operating leases;
 - recognition of lease income earned on investment property (see also IAS 18, revenue);
 - measurement in a lessee's financial statements of property held under an operating lease;
 - measurement in a lessor's financial statements of property leased out under a finance lease;
 - accounting for sale and leaseback transactions; and
 - disclosure about finance leases and operating leases.
- This Standard does not apply to:
 - biological assets attached to land related to agricultural activity (see IAS 41, agriculture); and
 - mineral rights, the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources.

DEFINITIONS

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

Investment property is property (land or a building — or part of a building — or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:

- use in the production or supply of goods or services or for administrative purposes; or***

- (b) *sale in the ordinary course of business.*

Owner-occupied property is property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes.

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

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

Carrying amount is the amount at which an asset is recognised in the balance sheet.

5. Investment property is held to earn rentals or for capital appreciation or both. Therefore, an investment property generates cash flows largely independently of the other assets held by an enterprise. This distinguishes investment property from owner-occupied property. The production or supply of goods or services (or the use of property for administrative purposes) generates cash flows that are attributable not merely to property, but also to other assets used in the production or supply process. IAS 16, property, plant and equipment, applies to owner-occupied property.
6. The following are examples of investment property:
- (a) land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business;
 - (b) land held for a currently undetermined future use. (If an enterprise has not determined that it will use the land either as owner-occupied property or for short-term sale in the ordinary course of business, the land is considered to be held for capital appreciation);
 - (c) a building owned by the reporting enterprise (or held by the reporting enterprise under a finance lease) and leased out under one or more operating leases; and
 - (d) a building that is vacant but is held to be leased out under one or more operating leases.
7. The following are examples of items that are not investment property and therefore fall outside the scope of this Standard:
- (a) property held for sale in the ordinary course of business or in the process of construction or development for such sale (see IAS 2, inventories), for example property acquired exclusively with a view to subsequent disposal in the near future or for development and resale;
 - (b) property being constructed or developed on behalf of third parties (see IAS 11, construction contracts);
 - (c) owner-occupied property (see IAS 16, property, plant and equipment), including (among other things) property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees (whether or not the employees pay rent at market rates) and owner-occupied property awaiting disposal; and
 - (d) property that is being constructed or developed for future use as investment property. IAS 16 applies to such property until construction or development is complete, at which time the property becomes investment property and this Standard applies. However, this Standard does apply to existing investment property that is being redeveloped for continued future use as investment property (see paragraph 52).

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8. Certain properties include a portion that is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes. If these portions could be sold separately (or leased out separately under a finance lease), an enterprise accounts for the portions separately. If the portions could not be sold separately, the property is investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.
9. In certain cases, an enterprise provides ancillary services to the occupants of a property held by the enterprise. An enterprise treats such a property as investment property if the services are a relatively insignificant component of the arrangement as a whole. An example would be where the owner of an office building provides security and maintenance services to the lessees who occupy the building.
10. In other cases, the services provided are a more significant component. For example, if an enterprise owns and manages a hotel, services provided to guests are a significant component of the arrangement as a whole. Therefore, an owner-managed hotel is owner-occupied property, rather than investment property.
11. It may be difficult to determine whether ancillary services are so significant that a property does not qualify as investment property. For example, the owner of a hotel sometimes transfers certain responsibilities to third parties under a management contract. The terms of such management contracts vary widely. At one end of the spectrum, the owner's position may, in substance, be that of a passive investor. At the other end of the spectrum, the owner may simply have outsourced certain day-to-day functions while retaining significant exposure to variation in the cash flows generated by the operations of the hotel.
12. Judgement is needed to determine whether a property qualifies as investment property. An enterprise develops criteria so that it can exercise that judgement consistently in accordance with the definition of investment property and with the related guidance in paragraphs 5 to 11. Paragraph 66(a) requires an enterprise to disclose these criteria when classification is difficult.
13. Under IAS 17, leases, a lessee does not capitalise property held under an operating lease. Therefore, the lessee does not treat its interest in such property as investment property.
14. In some cases, an enterprise owns property that is leased to, and occupied by, its parent or another subsidiary. The property does not qualify as investment property in consolidated financial statements that include both enterprises, because the property is owner-occupied from the perspective of the group as a whole. However, from the perspective of the individual enterprise that owns it, the property is investment property if it meets the definition in paragraph 4. Therefore, the lessor treats the property as investment property in its individual financial statements.

RECOGNITION

15. ***Investment property should be recognised as an asset when, and only when:***
 - (a) ***it is probable that the future economic benefits that are associated with the investment property will flow to the enterprise; and***
 - (b) ***the cost of the investment property can be measured reliably.***
16. In determining whether an item satisfies the first criterion for recognition, an enterprise needs to assess the degree of certainty attaching to the flow of future economic benefits on the basis of the available evidence at the time of initial recognition. The second criterion for recognition is usually readily satisfied because the exchange transaction evidencing the purchase of the asset identifies its cost.

INITIAL MEASUREMENT

17. ***An investment property should be measured initially at its cost. Transaction costs should be included in the initial measurement.***
18. The cost of a purchased investment property comprises its purchase price, and any directly attributable expenditure. Directly attributable expenditure includes, for example, professional fees for legal services, property transfer taxes and other transaction costs.
19. The cost of a self-constructed investment property is its cost at the date when the construction or development is complete. Until that date, an enterprise applies IAS 16, property, plant and equipment. At that date, the property becomes investment property and this Standard applies (see paragraphs 51(e) and 59).
20. The cost of an investment property is not increased by start-up costs (unless they are necessary to bring the property to its working condition), initial operating losses incurred before the investment property achieves the planned level of occupancy or abnormal amounts of wasted material, labour or other resources incurred in constructing or developing the property.
21. If payment for an investment property is deferred, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit.

SUBSEQUENT EXPENDITURE

22. ***Subsequent expenditure relating to an investment property that has already been recognised should be added to the carrying amount of the investment property when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing investment property, will flow to the enterprise. All other subsequent expenditure should be recognised as an expense in the period in which it is incurred.***
23. The appropriate accounting treatment for expenditure incurred subsequently to the acquisition of an investment property depends on the circumstances which were taken into account on the initial measurement and recognition of the related investment. For instance, when the carrying amount of an investment property already takes into account a loss in future economic benefits, subsequent expenditure to restore the future economic benefits expected from the asset is capitalised. This is also the case when the purchase price of an asset reflects the enterprise's obligation to incur expenditure that is necessary in the future to bring the asset to its working condition. An example of this might be the acquisition of a building requiring renovation. In such circumstances, the subsequent expenditure is added to the carrying amount.

MEASUREMENT SUBSEQUENT TO INITIAL RECOGNITION

24. ***An enterprise should choose either the fair value model in paragraphs 27 to 49 or the cost model in paragraph 50 as its accounting policy and should apply that policy to all of its investment property.***
25. IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies, states that a voluntary change in accounting policy should be made only if the change will result in a more appropriate presentation of events or transactions in the financial statements of the enterprise. It is highly unlikely that a change from the fair value model to the cost model will result in a more appropriate presentation.
26. This Standard requires all enterprises to determine the fair value of investment property for the purpose of measurement (fair value model) or disclosure (cost model). An enterprise is encouraged, but not required, to determine the fair value of investment property on the basis of a valuation by an independent valuer who holds a recognised and relevant professional qualification and who has recent experience in the location and category of the investment property being valued.

IAS 40*Fair value model*

27. ***After initial recognition, an enterprise that chooses the fair value model should measure all of its investment property at its fair value, except in the exceptional cases described in paragraph 47.***
28. ***A gain or loss arising from a change in the fair value of investment property should be included in net profit or loss for the period in which it arises.***
29. The fair value of investment property is usually its market value. Fair value is measured as the most probable price reasonably obtainable in the market at the balance sheet date in keeping with the fair value definition. It is the best price reasonably obtainable by the seller and the most advantageous price reasonably obtainable by the buyer. This estimate specifically excludes an estimated price inflated or deflated by special terms or circumstances such as atypical financing, sale and leaseback arrangements, special considerations or concessions granted by anyone associated with the sale.
30. An enterprise determines fair value without any deduction for transaction costs that the enterprise may incur on sale or other disposal.
31. ***The fair value of investment property should reflect the actual market state and circumstances as of the balance sheet date, not as of either a past or future date.***
32. The estimated fair value is time specific as of a given date. Because markets and market conditions may change, the estimated value may be incorrect or inappropriate at another time. The definition of fair value also assumes simultaneous exchange and completion of the contract for sale without any variation in price that might be made in an arm's length transaction between knowledgeable, willing parties if exchange and completion are not simultaneous.
33. The fair value of investment property reflects, among other things, rental income from current leases and reasonable and supportable assumptions that represent the market's view of what knowledgeable, willing parties would assume about rental income from future leases in the light of current market conditions.
34. The definition of fair value refers to 'knowledgeable, willing parties'. In this context, 'knowledgeable' means that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the investment property, its actual and potential uses, and the state of the market as of the balance sheet date.
35. A willing buyer is motivated, but not compelled to buy. This buyer is neither over-eager nor determined to buy at any price. This buyer is also one who purchases in accordance with the realities of the current market, and with the current market expectations, rather than an imaginary or hypothetical market that cannot be demonstrated or anticipated to exist. The assumed buyer would not pay a higher price than the market requires. The present owner of an investment property is included among those who constitute the market.
36. A willing seller is neither an over-eager nor a forced seller, prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in the current market. The willing seller is motivated to sell the investment property at market terms for the best price obtainable in the open market after proper marketing, whatever that price may be. The factual circumstances of the actual investment property owner are not a part of this consideration because the willing seller is a hypothetical owner.
37. The expression 'after proper marketing' means that the investment property would be exposed to the market in the most appropriate manner to effect its disposal at the best price reasonably obtainable. The length of exposure time may vary with market conditions, but must be sufficient to allow the investment property to be brought to the attention of an adequate number of potential purchasers. The exposure period is assumed to occur prior to the balance sheet date.

38. The definition of fair value refers to an arm's length transaction. An arm's length transaction is one between parties who do not have a particular or special relationship that makes prices of transactions uncharacteristic of the market. The transaction is presumed to be between unrelated parties, each acting independently.
39. The best evidence of fair value is normally given by current prices on an active market for similar property in the same location and condition and subject to similar lease and other contracts. An enterprise takes care to identify any differences in the nature, location or condition of the property, or in the contractual terms of the leases and other contracts relating to the property.
40. In the absence of current prices on an active market of the kind described in paragraph 39, an enterprise considers information from a variety of sources, including:
- (a) current prices on an active market for properties of different nature, condition or location (or subject to different lease or other contracts), adjusted to reflect those differences;
 - (b) recent prices on less active markets, with adjustments to reflect any changes in economic conditions since the date of the transactions that occurred at those prices; and
 - (c) discounted cash flow projections based on reliable estimates of future cash flows, supported by the terms of any existing lease and other contracts and (where possible) by external evidence such as current market rents for similar properties in the same location and condition, and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows.
41. In some cases, the various sources listed in the previous paragraph may suggest different conclusions as to the fair value of an investment property. An enterprise considers the reasons for those differences, in order to arrive at the most reliable estimate of fair value within a relatively narrow range of reasonable fair value estimates.
42. In exceptional cases, there is clear evidence when an enterprise first acquires an investment property (or when an existing property first becomes investment property following the completion of construction or development, or after a change in use) that the variability in the range of reasonable fair value estimates will be so great and the probabilities of the various outcomes will be so difficult to assess, that the usefulness of a single estimate of fair value is negated. This may indicate that the fair value of the property will not be determinable reliably on a continuing basis (see paragraph 47).
43. Fair value differs from value in use, as defined in IAS 36, impairment of assets. Fair value reflects knowledge and estimates of participants in the market, as well as factors that are relevant to market participants in general. In contrast, value in use reflects the enterprise's knowledge and estimates, as well as entity-specific factors that may be specific to the enterprise and that are not applicable to enterprises in general. For example, fair value does not reflect any:
- (a) additional value derived from the creation of a portfolio of properties in different locations;
 - (b) synergies between investment property and other assets;
 - (c) legal rights or legal restrictions that are specific only to the current owner; and
 - (d) tax benefits or tax burdens that are specific to the current owner.

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44. In determining the fair value of investment property, an enterprise avoids double counting of assets or liabilities that are recognised in the balance sheet as separate assets or liabilities. For example:
- (a) equipment such as elevators or air-conditioning is often an integral part of a building and is generally included in the investment property, rather than being recognised separately as property, plant and equipment;
 - (b) if an office is leased on a furnished basis, the fair value of the office generally includes the fair value of the furniture, because the rental income relates to the furnished office. When furniture is included in the fair value of investment property, an enterprise does not recognise that furniture as a separate asset; and
 - (c) the fair value of investment property excludes prepaid or accrued operating lease income, as the enterprise recognises it as a separate liability or asset.
45. The fair value of investment property does not reflect future capital expenditure that will improve or enhance the property and does not reflect the related future benefits from this future expenditure.
46. In some cases, an enterprise expects that the present value of its payments relating to an investment property (other than payments relating to recognised financial liabilities) will exceed the present value of the related cash receipts. An enterprise uses IAS 37, provisions, contingent liabilities and contingent assets, to determine whether the enterprise recognises a liability and how the enterprise measures any such liability.

Inability to measure fair value reliably

47. ***There is a rebuttable presumption that an enterprise will be able to determine the fair value of an investment property reliably on a continuing basis. However, in exceptional cases, there is clear evidence when an enterprise first acquires an investment property (or when an existing property first becomes investment property following the completion of construction or development, or after a change in use) that the enterprise will not be able to determine the fair value of the investment property reliably on a continuing basis. This arises when, and only when, comparable market transactions are infrequent and alternative estimates of fair value (for example, based on discounted cash flow projections) are not available. In such cases, an enterprise should measure that investment property using the benchmark treatment in IAS 16, property, plant and equipment. The residual value of the investment property should be assumed to be zero. The enterprise should continue to apply IAS 16 until the disposal of the investment property.***
48. In the exceptional cases when an enterprise is compelled, for the reason given in the previous paragraph, to measure an investment property using the IAS 16 benchmark treatment, the enterprise measures all its other investment property at fair value.
49. ***If an enterprise has previously measured an investment property at fair value, the enterprise should continue to measure the property at fair value until disposal (or until the property becomes owner-occupied property or the enterprise begins to develop the property for subsequent sale in the ordinary course of business) even if comparable market transactions become less frequent or market prices become less readily available.***

Cost model

50. ***After initial recognition, an enterprise that chooses the cost model should measure all of its investment property using the benchmark treatment in IAS 16, property, plant and equipment, that is, at cost less any accumulated depreciation and any accumulated impairment losses.***

TRANSFERS

51. ***Transfers to, or from, investment property should be made when, and only when, there is a change in use, evidenced by:***
- (a) ***commencement of owner-occupation, for a transfer from investment property to owner-occupied property;***
 - (b) ***commencement of development with a view to sale, for a transfer from investment property to inventories;***
 - (c) ***end of owner-occupation, for a transfer from owner-occupied property to investment property;***
 - (d) ***commencement of an operating lease to another party, for a transfer from inventories to investment property; or***
 - (e) ***end of construction or development, for a transfer from property in the course of construction or development (covered by IAS 16, property, plant and equipment) to investment property.***
52. Paragraph 51(b) above requires an enterprise to transfer a property from investment property to inventories when, and only when, there is a change in use, evidenced by commencement of development with a view to sale. When an enterprise decides to dispose of an investment property without development, the enterprise continues to treat the property as an investment property until it is derecognised (eliminated from the balance sheet) and does not treat it as inventory. Similarly, if an enterprise begins to redevelop an existing investment property for continued future use as investment property, it remains an investment property and is not reclassified as owner-occupied property during the redevelopment.
53. Paragraphs 54 to 59 deal with recognition and measurement issues that apply when an enterprise uses the fair value model for investment property. When an enterprise uses the cost model, transfers between investment property, owner-occupied property and inventories do not change the carrying amount of the property transferred and they do not change the cost of that property for measurement or disclosure purposes.
54. ***For a transfer from investment property carried at fair value to owner-occupied property or inventories, the property's cost for subsequent accounting under IAS 16 or IAS 2 should be its fair value at the date of change in use.***
55. ***If an owner-occupied property becomes an investment property that will be carried at fair value, an enterprise should apply IAS 16 up to the date of change in use. The enterprise should treat any difference at that date between the carrying amount of the property under IAS 16 and its fair value in the same way as a revaluation under IAS 16.***
56. Up to the date when an owner-occupied property becomes an investment property carried at fair value, an enterprise continues to depreciate the property and to recognise any impairment losses that have occurred. The enterprise treats any difference at that date between the carrying amount of the property under IAS 16 and its fair value in the same way as a revaluation under IAS 16. In other words:
- (a) any resulting decrease in the carrying amount of the property is recognised in net profit or loss for the period. However, to the extent that an amount is included in revaluation surplus for that property, the decrease is charged against that revaluation surplus; and

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- (b) any resulting increase in the carrying amount is treated as follows:
- (i) to the extent that the increase reverses a previous impairment loss for that property, the increase is recognised in net profit or loss for the period. The amount recognised in net profit or loss for the period does not exceed the amount needed to restore the carrying amount to the carrying amount that would have been determined (net of depreciation) had no impairment loss been recognised; and
 - (ii) any remaining part of the increase is credited directly to equity under the heading of revaluation surplus. On subsequent disposal of the investment property, the revaluation surplus included in equity may be transferred to retained earnings. The transfer from revaluation surplus to retained earnings is not made through the income statement.

57. ***For a transfer from inventories to investment property that will be carried at fair value, any difference between the fair value of the property at that date and its previous carrying amount should be recognised in net profit or loss for the period.***
58. The treatment of transfers from inventories to investment property that will be carried at fair value is consistent with the treatment of sales of inventories.
59. ***When an enterprise completes the construction or development of a self-constructed investment property that will be carried at fair value, any difference between the fair value of the property at that date and its previous carrying amount should be recognised in net profit or loss for the period.***

DISPOSALS

60. ***An investment property should be derecognised (eliminated from the balance sheet) on disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal.***
61. The disposal of an investment property may occur by sale or by entering into a finance lease. In determining the date of disposal for investment property, an enterprise applies the criteria in IAS 18, revenue, for recognising revenue from the sale of goods and considers the related guidance in the Appendix to IAS 18. IAS 17, leases, applies on a disposal by entering into a finance lease or by a sale and leaseback.
62. ***Gains or losses arising from the retirement or disposal of investment property should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the income statement (unless IAS 17, leases, requires otherwise on a sale and leaseback).***
63. The consideration receivable on disposal of an investment property is recognised initially at fair value. In particular, if payment for an investment property is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue under IAS 18 on a time proportion basis that takes into account the effective yield on the receivable.
64. An enterprise applies IAS 37, provisions, contingent liabilities and contingent assets, or other International Accounting Standards, as appropriate, to any liabilities that the enterprise retains after disposal of an investment property.

DISCLOSURE

Fair value model and cost model

65. The disclosures set out below apply in addition to those in IAS 17, leases. Under IAS 17, the owner of an investment property gives a lessor's disclosures about operating leases. Under IAS 17, an enterprise that holds an investment property under a finance lease gives a lessee's disclosures about that finance lease and a lessor's disclosure about any operating leases that the enterprise has granted.
66. **An enterprise should disclose:**
- (a) **when classification is difficult (see paragraph 12), the criteria developed by the enterprise to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business;**
 - (b) **the methods and significant assumptions applied in determining the fair value of investment property, including a statement whether the determination of fair value was supported by market evidence or was more heavily based on other factors (which the enterprise should disclose) because of the nature of the property and lack of comparable market data;**
 - (c) **the extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and who has recent experience in the location and category of the investment property being valued. If there has been no such valuation, that fact should be disclosed;**
 - (d) **the amounts included in the income statement for:**
 - (i) **rental income from investment property;**
 - (ii) **direct operating expenses (including repairs and maintenance) arising from investment property that generated rental income during the period; and**
 - (iii) **direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental income during the period;**
 - (e) **the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal; and**
 - (f) **material contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements.**

Fair value model

67. **In addition to the disclosure required by paragraph 66, an enterprise that applies the fair value model in paragraphs 27 to 49 should also disclose a reconciliation of the carrying amount of investment property at the beginning and end of the period showing the following (comparative information is not required):**
- (a) **additions, disclosing separately those additions resulting from acquisitions and those resulting from capitalised subsequent expenditure;**
 - (b) **additions resulting from acquisitions through business combinations;**
 - (c) **disposals;**

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- (d) *net gains or losses from fair value adjustments;*
 - (e) *the net exchange differences arising on the translation of the financial statements of a foreign entity;*
 - (f) *transfers to and from inventories and owner-occupied property; and*
 - (g) *other movements.*
68. *In the exceptional cases when an enterprise measures investment property using the benchmark treatment in IAS 16, property, plant and equipment (because of the lack of a reliable fair value, see paragraph 47 above), the reconciliation required by the previous paragraph should disclose amounts relating to that investment property separately from amounts relating to other investment property. In addition, an enterprise should disclose:*
- (a) *a description of the investment property;*
 - (b) *an explanation of why fair value cannot be reliably measured;*
 - (c) *if possible, the range of estimates within which fair value is highly likely to lie; and*
 - (d) *on disposal of investment property not carried at fair value:*
 - (i) *the fact that the enterprise has disposed of investment property not carried at fair value;*
 - (ii) *the carrying amount of that investment property at the time of sale; and*
 - (iii) *the amount of gain or loss recognised.*

Cost model

69. *In addition to the disclosure required by paragraph 66, an enterprise that applies the cost model in paragraph 50 should also disclose:*
- (a) *the depreciation methods used;*
 - (b) *the useful lives or the depreciation rates used;*
 - (c) *the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period;*
 - (d) *a reconciliation of the carrying amount of investment property at the beginning and end of the period showing the following (comparative information is not required):*
 - (i) *additions, disclosing separately those additions resulting from acquisitions and those resulting from capitalised subsequent expenditure;*
 - (ii) *additions resulting from acquisitions through business combinations;*
 - (iii) *disposals;*
 - (iv) *depreciation;*
 - (v) *the amount of impairment losses recognised, and the amount of impairment losses reversed, during the period under IAS 36, impairment of assets;*

- (vi) *the net exchange differences arising on the translation of the financial statements of a foreign entity;*
- (vii) *transfers to and from inventories and owner-occupied property; and*
- (viii) *other movements; and*
- (e) *the fair value of investment property. In the exceptional cases described in paragraph 47, when an enterprise cannot determine the fair value of the investment property reliably, the enterprise should disclose:*
 - (i) *a description of the investment property;*
 - (ii) *an explanation of why fair value cannot be determined reliably; and*
 - (iii) *if possible, the range of estimates within which fair value is highly likely to lie.*

TRANSITIONAL PROVISIONS

Fair value model

70. *Under the fair value model, an enterprise should report the effect of adopting this Standard on its effective date (or earlier) as an adjustment to the opening balance of retained earnings for the period in which the Standard is first adopted. In addition:*
- (a) *if the enterprise has previously disclosed publicly (in financial statements or otherwise) the fair value of its investment property in earlier periods (determined on a basis that satisfies the definition of fair value in paragraph 4 and the guidance in paragraphs 29 to 46), the enterprise is encouraged, but not required, to:*
 - (i) *adjust the opening balance of retained earnings for the earliest period presented for which such fair value was disclosed publicly; and*
 - (ii) *restate comparative information for those periods; and*
 - (b) *if the enterprise has not previously disclosed publicly the information described in (a), the enterprise should not restate comparative information and should disclose that fact.*
71. This Standard requires a different treatment from the benchmark and allowed alternative treatments for changes in accounting policies under IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies. IAS 8 requires comparative information to be restated (benchmark treatment) or additional pro forma comparative information on a restated basis to be disclosed (allowed alternative treatment) unless it is impracticable to do so.
72. When an enterprise first adopts this Standard, the adjustment to the opening balance of retained earnings includes the reclassification of any amount held in revaluation surplus for investment property.

Cost model

73. IAS 8 applies to any change in accounting policies that occurs when an enterprise first adopts this Standard and chooses to use the cost model. The effect of the change in accounting policies includes the reclassification of any amount held in revaluation surplus for investment property.

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EFFECTIVE DATE

74. ***This International Accounting Standard becomes operative for annual financial statements covering periods beginning on or after 1 January 2001. Earlier application is encouraged. If an enterprise applies this Standard for periods beginning before 1 January 2001, it should disclose that fact.***
75. This Standard supersedes IAS 25, accounting for investments, with respect to investment property.

INTERNATIONAL ACCOUNTING STANDARD IAS 41**Agriculture**

This International Accounting Standard was approved by the IASC Board in December 2000 and becomes effective for financial statements covering periods beginning on or after 1 January 2003.

INTRODUCTION

1. IAS 41 prescribes the accounting treatment, financial statement presentation, and disclosures related to agricultural activity, a matter not covered in other International Accounting Standards. Agricultural activity is the management by an enterprise of the biological transformation of living animals or plants (biological assets) for sale, into agricultural produce, or into additional biological assets.
2. IAS 41 prescribes, among other things, the accounting treatment for biological assets during the period of growth, degeneration, production, and procreation, and for the initial measurement of agricultural produce at the point of harvest. It requires measurement at fair value less estimated point-of-sale costs from initial recognition of biological assets up to the point of harvest, other than when fair value cannot be measured reliably on initial recognition. However, IAS 41 does not deal with processing of agricultural produce after harvest; for example, processing grapes into wine and wool into yarn.
3. There is a presumption that fair value can be measured reliably for a biological asset. However, that presumption can be rebutted only on initial recognition for a biological asset for which market-determined prices or values are not available and for which alternative estimates of fair value are determined to be clearly unreliable. In such a case, IAS 41 requires an enterprise to measure that biological asset at its cost less any accumulated depreciation and any accumulated impairment losses. Once the fair value of such a biological asset becomes reliably measurable, an enterprise should measure it at its fair value less estimated point-of-sale costs. In all cases, an enterprise should measure agricultural produce at the point of harvest at its fair value less estimated point-of-sale costs.
4. IAS 41 requires that a change in fair value less estimated point-of-sale costs of a biological asset be included in net profit or loss for the period in which it arises. In agricultural activity, a change in physical attributes of a living animal or plant directly enhances or diminishes economic benefits to the enterprise. Under a transaction-based, historical cost accounting model, a plantation forestry enterprise might report no income until first harvest and sale, perhaps 30 years after planting. On the other hand, an accounting model that recognises and measures biological growth using current fair values reports changes in fair value throughout the period between planting and harvest.

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5. IAS 41 does not establish any new principles for land related to agricultural activity. Instead, an enterprise follows IAS 16, property, plant and equipment, or IAS 40, investment property, depending on which standard is appropriate in the circumstances. IAS 16 requires land to be measured either at its cost less any accumulated impairment losses, or at a revalued amount. IAS 40 requires land that is investment property to be measured at its fair value, or cost less any accumulated impairment losses. Biological assets that are physically attached to land (for example, trees in a plantation forest) are measured at their fair value less estimated point-of-sale costs separately from the land.
6. IAS 41 requires that an unconditional government grant related to a biological asset measured at its fair value less estimated point-of-sale costs be recognised as income when, and only when, the government grant becomes receivable. If a government grant is conditional, including where a government grant requires an enterprise not to engage in specified agricultural activity, an enterprise should recognise the government grant as income when, and only when, the conditions attaching to the government grant are met. If a government grant relates to a biological asset measured at its cost less any accumulated depreciation and any accumulated impairment losses, IAS 20, accounting for government grants and disclosure of government assistance, is applied.
7. IAS 41 is effective for annual financial statements covering periods beginning on or after 1 January 2003. Earlier application is encouraged.
8. IAS 41 does not establish any specific transitional provisions. The adoption of IAS 41 is accounted for in accordance with IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies.
9. Appendix A provides illustrative examples of the application of IAS 41. Appendix B, Basis for conclusions, summarises the Board's reasons for adopting the requirements set out in IAS 41.

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

OBJECTIVE

The objective of this Standard is to prescribe the accounting treatment, financial statement presentation, and disclosures related to agricultural activity.

SCOPE

1. ***This Standard should be applied to account for the following when they relate to agricultural activity:***
 - (a) ***biological assets;***
 - (b) ***agricultural produce at the point of harvest; and***
 - (c) ***government grants covered by paragraphs 34 to 35.***
2. This Standard does not apply to:
 - (a) land related to agricultural activity (see IAS 16, property, plant and equipment, and IAS 40, investment property); and
 - (b) intangible assets related to agricultural activity (see IAS 38, intangible assets).
3. This Standard is applied to agricultural produce, which is the harvested product of the enterprise's biological assets, only at the point of harvest. Thereafter, IAS 2, inventories, or another applicable International Accounting Standard is applied. Accordingly, this Standard does not deal with the processing of agricultural produce after harvest; for example, the processing of grapes into wine by a vintner who has grown the grapes. While such processing may be a logical and natural extension of agricultural activity, and the events taking place may bear some similarity to biological transformation, such processing is not included within the definition of agricultural activity in this Standard.
4. The table below provides examples of biological assets, agricultural produce, and products that are the result of processing after harvest:

Biological assets	Agricultural produce	Products that are the result of processing after harvest
Sheep	Wool	Yarn, carpet
Trees in a plantation forest	Logs	Lumber
Plants	Cotton Harvested cane	Thread, clothing Sugar
Dairy cattle	Milk	Cheese
Pigs	Carcase	Sausages, cured hams
Bushes	Leaf	Tea, cured tobacco
Vines	Grapes	Wine
Fruit trees	Picked fruit	Processed fruit

DEFINITIONS

Agriculture-related definitions

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

Agricultural activity is the management by an enterprise of the biological transformation of biological assets for sale, into agricultural produce, or into additional biological assets.

Agricultural produce is the harvested product of the enterprise's biological assets.

A biological asset is a living animal or plant.

Biological transformation comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset.

A group of biological assets is an aggregation of similar living animals or plants.

Harvest is the detachment of produce from a biological asset or the cessation of a biological asset's life processes.

6. Agricultural activity covers a diverse range of activities; for example, raising livestock, forestry, annual or perennial cropping, cultivating orchards and plantations, floriculture, and aquaculture (including fish farming). Certain common features exist within this diversity:
- (a) Capability to change: living animals and plants are capable of biological transformation;
 - (b) Management of change: management facilitates biological transformation by enhancing, or at least stabilising, conditions necessary for the process to take place (for example, nutrient levels, moisture, temperature, fertility, and light). Such management distinguishes agricultural activity from other activities. For example, harvesting from unmanaged sources (such as ocean fishing and deforestation) is not agricultural activity; and
 - (c) Measurement of change: the change in quality (for example, genetic merit, density, ripeness, fat cover, protein content, and fibre strength) or quantity (for example, progeny, weight, cubic metres, fibre length or diameter, and number of buds) brought about by biological transformation is measured and monitored as a routine management function.
7. Biological transformation results in the following types of outcomes:
- (a) asset changes through (i) growth (an increase in quantity or improvement in quality of an animal or plant); (ii) degeneration (a decrease in the quantity or deterioration in quality of an animal or plant); or (iii) procreation (creation of additional living animals or plants); or
 - (b) production of agricultural produce such as latex, tea leaf, wool, and milk.

General definitions

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

An active market is a market where all the following conditions exist:

- (a) **the items traded within the market are homogeneous;**
- (b) **willing buyers and sellers can normally be found at any time; and**
- (c) **prices are available to the public.**

Carrying amount is the amount at which an asset is recognised in the balance sheet.

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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.

Government grants are as defined in IAS 20, accounting for government grants and disclosure of government assistance.

9. The fair value of an asset is based on its present location and condition. As a result, for example, the fair value of cattle at a farm is the price for the cattle in the relevant market less the transport and other costs of getting the cattle to that market.

RECOGNITION AND MEASUREMENT

10. ***An enterprise should recognise a biological asset or agricultural produce when, and only when:***
 - (a) *the enterprise controls the asset as a result of past events;*
 - (b) *it is probable that future economic benefits associated with the asset will flow to the enterprise; and*
 - (c) *the fair value or cost of the asset can be measured reliably.*
11. In agricultural activity, control may be evidenced by, for example, legal ownership of cattle and the branding or otherwise marking of the cattle on acquisition, birth, or weaning. The future benefits are normally assessed by measuring the significant physical attributes.
12. ***A biological asset should be measured on initial recognition and at each balance sheet date at its fair value less estimated point-of-sale costs, except for the case described in paragraph 30 where the fair value cannot be measured reliably.***
13. ***Agricultural produce harvested from an enterprise's biological assets should be measured at its fair value less estimated point-of-sale costs at the point of harvest. Such measurement is the cost at that date when applying IAS 2, inventories, or another applicable International Accounting Standard.***
14. Point-of-sale costs include commissions to brokers and dealers, levies by regulatory agencies and commodity exchanges, and transfer taxes and duties. Point-of-sale costs exclude transport and other costs necessary to get assets to a market.
15. The determination of fair value for a biological asset or agricultural produce may be facilitated by grouping biological assets or agricultural produce according to significant attributes; for example, by age or quality. An enterprise selects the attributes corresponding to the attributes used in the market as a basis for pricing.
16. Enterprises often enter into contracts to sell their biological assets or agricultural produce at a future date. Contract prices are not necessarily relevant in determining fair value, because fair value reflects the current market in which a willing buyer and seller would enter into a transaction. As a result, the fair value of a biological asset or agricultural produce is not adjusted because of the existence of a contract. In some cases, a contract for the sale of a biological asset or agricultural produce may be an onerous contract, as defined in IAS 37, provisions, contingent liabilities and contingent assets. IAS 37 applies to onerous contracts.
17. If an active market exists for a biological asset or agricultural produce, the quoted price in that market is the appropriate basis for determining the fair value of that asset. If an enterprise has access to different active markets, the enterprise uses the most relevant one. For example, if an enterprise has access to two active markets, it would use the price existing in the market expected to be used.

18. If an active market does not exist, an enterprise uses one or more of the following, when available, in determining fair value:
- (a) the most recent market transaction price, provided that there has not been a significant change in economic circumstances between the date of that transaction and the balance sheet date;
 - (b) market prices for similar assets with adjustment to reflect differences; and
 - (c) sector benchmarks such as the value of an orchard expressed per export tray, bushel, or hectare, and the value of cattle expressed per kilogram of meat.
19. In some cases, the information sources listed in paragraph 18 may suggest different conclusions as to the fair value of a biological asset or agricultural produce. An enterprise considers the reasons for those differences, in order to arrive at the most reliable estimate of fair value within a relatively narrow range of reasonable estimates.
20. In some circumstances, market-determined prices or values may not be available for a biological asset in its present condition. In these circumstances, an enterprise uses the present value of expected net cash flows from the asset discounted at a current market-determined pre-tax rate in determining fair value.
21. The objective of a calculation of the present value of expected net cash flows is to determine the fair value of a biological asset in its present location and condition. An enterprise considers this in determining an appropriate discount rate to be used and in estimating expected net cash flows. The present condition of a biological asset excludes any increases in value from additional biological transformation and future activities of the enterprise, such as those related to enhancing the future biological transformation, harvesting, and selling.
22. An enterprise does not include any cash flows for financing the assets, taxation, or re-establishing biological assets after harvest (for example, the cost of replanting trees in a plantation forest after harvest).
23. In agreeing an arm's length transaction price, knowledgeable, willing buyers and sellers consider the possibility of variations in cash flows. It follows that fair value reflects the possibility of such variations. Accordingly, an enterprise incorporates expectations about possible variations in cash flows into either the expected cash flows, or the discount rate, or some combination of the two. In determining a discount rate, an enterprise uses assumptions consistent with those used in estimating the expected cash flows, to avoid the effect of some assumptions being double-counted or ignored.
24. Cost may sometimes approximate fair value, particularly when:
- (a) little biological transformation has taken place since initial cost incurrence (for example, for fruit tree seedlings planted immediately prior to a balance sheet date); or
 - (b) the impact of the biological transformation on price is not expected to be material (for example, for the initial growth in a 30-year pine plantation production cycle).
25. Biological assets are often physically attached to land (for example, trees in a plantation forest). There may be no separate market for biological assets that are attached to the land but an active market may exist for the combined assets, that is, for the biological assets, raw land, and land improvements, as a package. An enterprise may use information regarding the combined assets to determine fair value for the biological assets. For example, the fair value of raw land and land improvements may be deducted from the fair value of the combined assets to arrive at the fair value of biological assets.

IAS 41*Gains and losses*

26. ***A gain or loss arising on initial recognition of a biological asset at fair value less estimated point-of-sale costs and from a change in fair value less estimated point-of-sale costs of a biological asset should be included in net profit or loss for the period in which it arises.***
27. A loss may arise on initial recognition of a biological asset, because estimated point-of-sale costs are deducted in determining fair value less estimated point-of-sale costs of a biological asset. A gain may arise on initial recognition of a biological asset, such as when a calf is born.
28. ***A gain or loss arising on initial recognition of agricultural produce at fair value less estimated point-of-sale costs should be included in net profit or loss for the period in which it arises.***
29. A gain or loss may arise on initial recognition of agricultural produce as a result of harvesting.

Inability to measure fair value reliably

30. ***There is a presumption that fair value can be measured reliably for a biological asset. However, that presumption can be rebutted only on initial recognition for a biological asset for which market-determined prices or values are not available and for which alternative estimates of fair value are determined to be clearly unreliable. In such a case, that biological asset should be measured at its cost less any accumulated depreciation and any accumulated impairment losses. Once the fair value of such a biological asset becomes reliably measurable, an enterprise should measure it at its fair value less estimated point-of-sale costs.***
31. The presumption in paragraph 30 can be rebutted only on initial recognition. An enterprise that has previously measured a biological asset at its fair value less estimated point-of-sale costs continues to measure the biological asset at its fair value less estimated point-of-sale costs until disposal.
32. In all cases, an enterprise measures agricultural produce at the point of harvest at its fair value less estimated point-of-sale costs. This Standard reflects the view that the fair value of agricultural produce at the point of harvest can always be measured reliably.
33. In determining cost, accumulated depreciation and accumulated impairment losses, an enterprise considers IAS 2, inventories, IAS 16, property, plant and equipment, and IAS 36, impairment of assets.

GOVERNMENT GRANTS

34. ***An unconditional government grant related to a biological asset measured at its fair value less estimated point-of-sale costs should be recognised as income when, and only when, the government grant becomes receivable.***
35. ***If a government grant related to a biological asset measured at its fair value less estimated point-of-sale costs is conditional, including where a government grant requires an enterprise not to engage in specified agricultural activity, an enterprise should recognise the government grant as income when, and only when, the conditions attaching to the government grant are met.***
36. Terms and conditions of government grants vary. For example, a government grant may require an enterprise to farm in a particular location for five years and require the enterprise to return all of the government grant if it farms for less than five years. In this case, the government grant is not recognised as income until the five years have passed. However, if the government grant allows part of the government grant to be retained based on the passage of time, the enterprise recognises the government grant as income on a time proportion basis.

37. If a government grant relates to a biological asset measured at its cost less any accumulated depreciation and any accumulated impairment losses (see paragraph 30), IAS 20, accounting for government grants and disclosure of government assistance, is applied.
38. This Standard requires a different treatment from IAS 20, if a government grant relates to a biological asset measured at its fair value less estimated point-of-sale costs or a government grant requires an enterprise not to engage in specified agricultural activity. IAS 20 is applied only to a government grant related to a biological asset measured at its cost less any accumulated depreciation and any accumulated impairment losses.

PRESENTATION AND DISCLOSURE

Presentation

39. ***An enterprise should present the carrying amount of its biological assets separately on the face of its balance sheet.***

Disclosure

General

40. ***An enterprise should disclose the aggregate gain or loss arising during the current period on initial recognition of biological assets and agricultural produce and from the change in fair value less estimated point-of-sale costs of biological assets.***
41. ***An enterprise should provide a description of each group of biological assets.***
42. The disclosure required by paragraph 41 may take the form of a narrative or quantified description.
43. An enterprise is encouraged to provide a quantified description of each group of biological assets, distinguishing between consumable and bearer biological assets or between mature and immature biological assets, as appropriate. For example, an enterprise may disclose the carrying amounts of consumable biological assets and bearer biological assets by group. An enterprise may further divide those carrying amounts between mature and immature assets. These distinctions provide information that may be helpful in assessing the timing of future cash flows. An enterprise discloses the basis for making any such distinctions.
44. Consumable biological assets are those that are to be harvested as agricultural produce or sold as biological assets. Examples of consumable biological assets are livestock intended for the production of meat, livestock held for sale, fish in farms, crops such as maize and wheat, and trees being grown for lumber. Bearer biological assets are those other than consumable biological assets; for example, livestock from which milk is produced, grape vines, fruit trees, and trees from which firewood is harvested while the tree remains. Bearer biological assets are not agricultural produce but, rather, are self-regenerating.
45. Biological assets may be classified either as mature biological assets or immature biological assets. Mature biological assets are those that have attained harvestable specifications (for consumable biological assets) or are able to sustain regular harvests (for bearer biological assets).
46. ***If not disclosed elsewhere in information published with the financial statements, an enterprise should describe:***
- (a) ***the nature of its activities involving each group of biological assets; and***

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- (b) *non-financial measures or estimates of the physical quantities of:*
- (i) *each group of the enterprise's biological assets at the end of the period; and*
 - (ii) *output of agricultural produce during the period.*
47. *An enterprise should disclose the methods and significant assumptions applied in determining the fair value of each group of agricultural produce at the point of harvest and each group of biological assets.*
48. *An enterprise should disclose the fair value less estimated point-of-sale costs of agricultural produce harvested during the period, determined at the point of harvest.*
49. *An enterprise should disclose:*
- (a) *the existence and carrying amounts of biological assets whose title is restricted, and the carrying amounts of biological assets pledged as security for liabilities;*
 - (b) *the amount of commitments for the development or acquisition of biological assets; and*
 - (c) *financial risk management strategies related to agricultural activity.*
50. *An enterprise should present a reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the current period. Comparative information is not required. The reconciliation should include:*
- (a) *the gain or loss arising from changes in fair value less estimated point-of-sale costs;*
 - (b) *increases due to purchases;*
 - (c) *decreases due to sales;*
 - (d) *decreases due to harvest;*
 - (e) *increases resulting from business combinations;*
 - (f) *net exchange differences arising on the translation of financial statements of a foreign entity; and*
 - (g) *other changes.*
51. The fair value less estimated point-of-sale costs of a biological asset can change due to both physical changes and price changes in the market. Separate disclosure of physical and price changes is useful in appraising current period performance and future prospects, particularly when there is a production cycle of more than one year. In such cases, an enterprise is encouraged to disclose, by group or otherwise, the amount of change in fair value less estimated point-of-sale costs included in net profit or loss due to physical changes and due to price changes. This information is generally less useful when the production cycle is less than one year (for example, when raising chickens or growing cereal crops).
52. Biological transformation results in a number of types of physical change — growth, degeneration, production, and procreation, each of which is observable and measurable. Each of those physical changes has a direct relationship to future economic benefits. A change in fair value of a biological asset due to harvesting is also a physical change.
53. Agricultural activity is often exposed to climatic, disease, and other natural risks. If an event occurs that because of its size, nature, or incidence is relevant to understanding the enterprise's performance for the period, the nature and amount of related items of income and expense are disclosed under IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies. Examples include an outbreak of a virulent disease, a flood, severe droughts or frosts, and a plague of insects.

Additional disclosures for biological assets where fair value cannot be measured reliably

54. *If an enterprise measures biological assets at their cost less any accumulated depreciation and any accumulated impairment losses (see paragraph 30) at the end of the period, the enterprise should disclose for such biological assets:*
- (a) *a description of the biological assets;*
 - (b) *an explanation of why fair value cannot be measured reliably;*
 - (c) *if possible, the range of estimates within which fair value is highly likely to lie;*
 - (d) *the depreciation method used;*
 - (e) *the useful lives or the depreciation rates used; and*
 - (f) *the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.*
55. *If, during the current period, an enterprise measures biological assets at their cost less any accumulated depreciation and any accumulated impairment losses (see paragraph 30), an enterprise should disclose any gain or loss recognised on disposal of such biological assets and the reconciliation required by paragraph 50 should disclose amounts related to such biological assets separately. In addition, the reconciliation should include the following amounts included in net profit or loss related to those biological assets:*
- (a) *impairment losses;*
 - (b) *reversals of impairment losses; and*
 - (c) *depreciation.*
56. *If the fair value of biological assets previously measured at their cost less any accumulated depreciation and any accumulated impairment losses becomes reliably measurable during the current period, an enterprise should disclose for those biological assets:*
- (a) *a description of the biological assets;*
 - (b) *an explanation of why fair value has become reliably measurable; and*
 - (c) *the effect of the change.*

Government grants

57. *An enterprise should disclose the following related to agricultural activity covered by this Standard:*
- (a) *the nature and extent of government grants recognised in the financial statements;*
 - (b) *unfulfilled conditions and other contingencies attaching to government grants; and*
 - (c) *significant decreases expected in the level of government grants.*

EFFECTIVE DATE AND TRANSITION

58. *This International Accounting Standard becomes operative for annual financial statements covering periods beginning on or after 1 January 2003. Earlier application is encouraged. If an enterprise applies this Standard for periods beginning before 1 January 2003, it should disclose that fact.*
59. This Standard does not establish any specific transitional provisions. The adoption of this Standard is accounted for in accordance with IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies.

SIC-1/SIC-2

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-1

Consistency — different cost formulas for inventories

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Reference: IAS 2, inventories.

Issue

1. IAS 2.21 and 2.23 allow various cost formulas (FIFO, weighted average cost or LIFO) for inventories that are ordinarily interchangeable or are not produced and segregated for specific projects.
2. The issue is whether an enterprise may use different cost formulas for different types of inventories.

Consensus

3. An enterprise should use the same cost formula for all inventories having similar nature and use to the enterprise. For inventories with a different nature or use (for example, certain commodities used in one business segment and the same type of commodities used in another business segment), different cost formulas may be justified. A difference in geographical location of inventories (and in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas.

Date of consensus: July 1997.

Effective date: Periods beginning on or after 1 January 1999; earlier application is encouraged. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-2

Consistency — capitalisation of borrowing costs

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Reference: IAS 23, borrowing costs.

Issue

1. IAS 23.07 and 23.11 allow the choice of either:
 - (a) recognising all borrowing costs as an expense in the period in which they are incurred (benchmark treatment); or

- (b) capitalising borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets as part of the cost of that asset (allowed alternative treatment).
2. The issue is whether an enterprise that has chosen a policy of capitalising borrowing costs should apply this policy to all qualifying assets or whether an enterprise may choose to capitalise borrowing costs for certain qualifying assets and not for others.

Consensus

3. Where an enterprise adopts the allowed alternative treatment, that treatment should be applied consistently to all borrowing costs that are directly attributable to the acquisition, construction or production of all qualifying assets of the enterprise. If all the conditions laid down in IAS 23.11 are met, an enterprise should continue to capitalise such borrowing costs even if the carrying amount of the asset exceeds its recoverable amount. However, IAS 23.19 explains that the carrying amount of the asset should be written down to recognise impairment losses in such cases.

Date of consensus: July 1997.

Effective date: Periods beginning on or after 1 January 1998; earlier application is encouraged. Changes in accounting policies should be accounted for using the transition requirements of IAS 23.30. Therefore, an enterprise using the allowed alternative treatment may choose not to capitalise all borrowing costs incurred before the effective date of this interpretation.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-3

Elimination of unrealised profits and losses on transactions with associates

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Reference: IAS 28, accounting for investments in associates.

Issue

1. Although IAS 28.16 refers to consolidation procedures set out in IAS 27, it does not give explicit guidance on the elimination of unrealised profits and losses resulting from 'upstream' or 'downstream' transactions between an investor (or its consolidated subsidiaries) and associates. 'Upstream' transactions are, for example, sales of assets from an associate to the investor (or its consolidated subsidiaries). 'Downstream' transactions are, for example, sales of assets from the investor (or its consolidated subsidiaries) to an associate.
2. The issue is to what extent an investor should eliminate unrealised profits and losses resulting from transactions between an investor (or its consolidated subsidiaries) and associates accounted for using the equity method.

Consensus

3. Where an associate is accounted for using the equity method, unrealised profits and losses resulting from 'upstream' and 'downstream' transactions between an investor (or its consolidated subsidiaries) and associates should be eliminated to the extent of the investor's interest in the associate.

SIC-6

4. Unrealised losses should not be eliminated to the extent that the transaction provides evidence of an impairment of the asset transferred.

Date of consensus: July 1997.

Effective date: periods beginning on or after 1 January 1998; earlier application is encouraged. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-6**Costs of modifying existing software**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Reference: IASC framework for the preparation and presentation of financial statements.

Issue

1. Enterprises may incur considerable costs in modifying existing software systems. For example, such costs may be incurred to enable them to continue to operate as intended after the turn of the millennium (often referred to as 'software 2000 costs') or after the introduction of a new currency (e.g. the 'euro').
2. The issues are:
 - (a) whether such costs may be capitalised; and if not,
 - (b) when such costs should be recognised as an expense.
3. This interpretation does not address (a) the costs of modifying software produced for sale, (b) purchases of replacement software, (c) enhancements of the system ('upgrading') beyond those necessary to enable the systems to continue to perform as anticipated, and (d) the recognition of impairment losses related to existing computer software.

Consensus

4. Costs incurred in order to restore or maintain the future economic benefits that an enterprise can expect from the originally assessed standard of performance of existing software systems should be recognised as an expense when, and only when, the restoration or maintenance work is carried out (for example, to enable them to operate as originally intended after the turn of the millennium or after the introduction of the euro).

Disclosure

5. A need for major software modifications may give rise to uncertainties. In accordance with IAS 1.08 (revised 1997), enterprises are encouraged to present, outside the financial statements, information about the principal uncertainties they face (for example, a description of the activities and expenditure both incurred and planned to be incurred in future periods, in respect of significant software modifications).

Date of consensus: October 1997.

Effective date: this interpretation becomes effective on 1 June 1998. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-7

Introduction of the euro

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Reference: IAS 21, the effects of changes in foreign exchange rates.

Issue

1. From 1 January 1999, the effective start of economic and monetary union (EMU), the euro will become a currency in its own right and the conversion rates between the euro and the participating national currencies will be irrevocably fixed, i.e. the risk of subsequent exchange differences related to these currencies is eliminated from this date on.
2. The issue is the application of IAS 21 to the changeover from the national currencies of participating Member States of the European Union to the euro ('the changeover').

Consensus

3. The requirements of IAS 21 regarding the translation of foreign currency transactions and financial statements of foreign operations should be strictly applied to the changeover. The same rationale applies to the fixing of exchange rates when countries join EMU at later stages.
4. This means that, in particular:
 - (a) foreign currency monetary assets and liabilities resulting from transactions should continue to be translated into the reporting currency at the closing rate. Any resultant exchange differences should be recognised as income or expense immediately, except that an enterprise should continue to apply its existing accounting policy for exchange gains and losses related to foreign exchange contracts that are used to reduce the exchange risk on future transactions or commitments (anticipatory hedges);
 - (b) cumulative exchange differences relating to the translation of financial statements of foreign entities should continue to be classified as equity and should be recognised as income or expense only on the disposal of the net investment in the foreign entity; and
 - (c) exchange differences resulting from the translation of liabilities denominated in participating currencies should not be included in the carrying amount of related assets.

Date of consensus: October 1997.

Effective date: this interpretation becomes effective on 1 June 1998. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-8

First-time application of IASs as the primary basis of accounting

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Reference: IAS 1, presentation of financial statements.

SIC-8*Issue*

1. An enterprise wishes to describe its financial statements for the first time as complying in full with International Accounting Standards ('IASs'). It may, for example, previously have presented its financial statements using only national accounting requirements ('national GAAP') as the primary basis of accounting. It may also have presented its financial statements based in part on national GAAP and in part on IASs, in which case national GAAP would be considered as the previous primary accounting basis. IAS 1 (revised 1997) and IAS 8 do not give explicit guidance on how to account for the transition from national GAAP to IASs as the primary accounting basis.
2. The issues are:
 - (a) how the financial statements of an enterprise should be prepared and presented in the period when IASs are first applied in full as the primary accounting basis; and
 - (b) when IASs are first applied in full as the primary accounting basis, how specific transitional provisions set out in individual standards and interpretations should be applied to balances of items that existed already at the effective date of those standards and interpretations.

Consensus

3. In the period when IASs are applied in full for the first time as the primary accounting basis, the financial statements of an enterprise should be prepared and presented as if the financial statements had always been prepared in accordance with the standards and interpretations effective for the period of first-time application. Therefore, the standards and interpretations effective for the period of first-time application should be applied retrospectively, except when:
 - (a) individual standards or interpretations require or permit a different transitional treatment; or
 - (b) the amount of the adjustment relating to prior periods cannot be reasonably determined.
4. Comparative information should be prepared and presented in accordance with IASs.
5. Any adjustment resulting from the transition to IASs should be treated as an adjustment to the opening balance of retained earnings of the earliest period presented in accordance with IASs.
6. When IASs are applied in full as the primary accounting basis for the first time, an enterprise should apply the transitional provisions of the effective standards and interpretations only for periods ending on the date prescribed in the respective standards and interpretations.

Disclosure

7. In the period when IASs are applied in full for the first time as the primary accounting basis, an enterprise should disclose:
 - (a) where the amount of the adjustment to the opening balance of retained earnings cannot be reasonably determined, that fact;
 - (b) where it is impracticable to provide comparative information, that fact; and
 - (c) for each IAS that permits a choice of transitional accounting policies, the policy selected.
8. Enterprises are encouraged to disclose, in connection with the disclosures required by IAS 1.11 (revised 1997), the fact that IASs are being applied in full for the first time.

Date of consensus: January 1998.

Effective date: This interpretation becomes effective on 1 August 1998.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-9

Business combinations — classification either as acquisitions or unitings of interests

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Reference: IAS 22 (revised 1998), business combinations (1).

ISSUE

1. In order to classify a business combination, IAS 22 (revised 1998) ('IAS 22') contains both general definitions in paragraph 8 and additional guidance in paragraphs 10 to 12 for acquisitions and in paragraphs 13 to 16 for unitings of interests. IAS 22 is clear that it will be possible to identify an acquirer in virtually all cases and hence unitings of interests are expected to occur in exceptional circumstances only. However, the standard does not provide explicit guidance on the interaction between the definitions and the two sections containing guidance on acquisitions and unitings of interests.
2. The issues are:
 - (a) how the definitions and the additional guidance in IAS 22 are to be interpreted and applied in classifying a business combination; and
 - (b) whether a business combination under IAS 22 might be classified as neither an acquisition nor a uniting of interests.
3. This interpretation does not deal with transactions among enterprises under common control.

Consensus

4. A business combination should be accounted for as an acquisition, unless an acquirer cannot be identified. In virtually all business combinations an acquirer can be identified, i.e. the shareholders of one of the combining enterprises obtain control over the combined enterprise.
5. The classification of a business combination should be based on an overall evaluation of all relevant facts and circumstances of the particular transaction. The guidance given in IAS 22 provides examples of important factors to be considered, not a comprehensive set of conditions to be met. Single characteristics of a combined enterprise such as voting power or relative fair values of the combining enterprises should not be evaluated in isolation in order to determine how a business combination should be accounted for.
6. IAS 22.15(a), (b) and (c) describe the essential characteristics of a uniting of interests. An enterprise should classify a business combination as an acquisition, unless all of these three characteristics are present. Even if all of the three characteristics are present, an enterprise should classify a business combination as a uniting of interests only if the enterprise can demonstrate that an acquirer cannot be identified.
7. All business combinations under IAS 22 are either an 'acquisition' or a 'uniting of interests'.

Date of consensus: January 1998.

Effective date: This interpretation becomes effective for business combinations given initial accounting recognition in periods beginning on or after 1 August 1998.

(1) IAS 22 (revised 1993) was superseded by IAS 22 (revised 1998), business combinations, effective 1 July 1999. The cross-references in this interpretation have been updated to conform with IAS 22 (revised 1998).

SIC-10/SIC-11**STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-10****Government assistance — no specific relation to operating activities**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Reference: IAS 20, accounting for government grants and disclosure of government assistance.

Issue

1. In some countries government assistance to enterprises may be aimed at encouragement or long-term support of business activities either in certain regions or industry sectors. Conditions to receive such assistance may not be specifically related to the operating activities of the enterprise. Examples of such assistance are transfers of resources by governments to enterprises which:
 - (a) operate in a particular industry;
 - (b) continue operating in recently privatised industries; or
 - (c) start or continue to run their business in underdeveloped areas.
2. The issue is whether such government assistance is a 'government grant' within the scope of IAS 20 and, therefore, should be accounted for in accordance with this standard.

Consensus

3. Government assistance to enterprises meets the definition of government grants in IAS 20, even if there are no conditions specifically relating to the operating activities of the enterprise other than the requirement to operate in certain regions or industry sectors. Such grants should therefore not be credited directly to equity.

Date of consensus: January 1998.

Effective date: This interpretation becomes effective on 1 August 1998. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-11**Foreign exchange — capitalisation of losses resulting from severe currency devaluations**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Reference: IAS 21, the effects of changes in foreign exchange rates.

Issue

1. An enterprise has liabilities denominated in a foreign currency that result from the acquisition of assets. After the acquisition of the assets, the enterprise's reporting currency undergoes a severe devaluation or depreciation. As a result, significant foreign exchange losses arise when the liabilities are measured at the closing rate under IAS 21.11(a). The allowed alternative treatment in IAS 21.21 requires several conditions to apply before an enterprise may include such exchange losses in the carrying amount of the related assets.
2. The issues are:
 - (a) in which period the conditions that the liability 'cannot be settled' and that there is 'no practical means of hedging' should be applied; and
 - (b) when the acquisition of an asset is 'recent'.

Consensus

3. Foreign exchange losses on liabilities should be included in the carrying amount of a related asset only if those liabilities could not have been settled and if it was impracticable to hedge them prior to the occurrence of the severe devaluation or depreciation of the reporting currency. The adjusted carrying amount of the asset should not exceed its recoverable amount.
4. In order to include foreign exchange losses on liabilities in the carrying amount of a related asset, it should be demonstrated that the foreign currency necessary for settlement of the liability was not available to the reporting enterprise and that it was impracticable to hedge the exchange risk (for example, with derivatives such as forward contracts, options or other financial instruments). This is expected to occur only rarely, for example, simultaneous shortage of foreign currency due to exchange control restrictions imposed by a government or a central bank and no availability of hedging instruments.
5. Once the conditions for capitalisation of exchange losses are met, an enterprise should capitalise further exchange losses incurred after the first severe devaluation or depreciation of the reporting currency only to the extent that all conditions for capitalisation continue to be met.
6. 'Recent' acquisitions of assets are acquisitions within 12 months prior to the severe devaluation or depreciation of the reporting currency.

Date of consensus: January 1998.

Effective date: This interpretation becomes effective on 1 August 1998. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-12**Consolidation — special purpose entities**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Reference: IAS 27, consolidated financial statements and accounting for investments in subsidiaries.

SIC-12*Issue*

1. An entity may be created to accomplish a narrow and well-defined objective (e.g. to effect a lease, research and development activities or a securitisation of financial assets). Such a special purpose entity ('SPE') may take the form of a corporation, trust, partnership or unincorporated entity. SPEs often are created with legal arrangements that impose strict and sometimes permanent limits on the decision-making powers of their governing board, trustee or management over the operations of the SPE. Frequently, these provisions specify that the policy guiding the ongoing activities of the SPE cannot be modified, other than perhaps by its creator or sponsor (i.e. they operate on 'autopilot').
2. The sponsor (or enterprise on whose behalf the SPE was created) frequently transfers assets to the SPE, obtains the right to use assets held by the SPE or performs services for the SPE, while other parties ('capital providers') may provide the funding to the SPE. An enterprise that engages in transactions with an SPE (frequently the creator or sponsor) may in substance control the SPE.
3. A beneficial interest in an SPE may, for example, take the form of a debt instrument, an equity instrument, a participation right, a residual interest or a lease. Some beneficial interests may simply provide the holder with a fixed or stated rate of return, while others give the holder rights or access to other future economic benefits of the SPE's activities. In most cases, the creator or sponsor (or the enterprise on whose behalf the SPE was created) retains a significant beneficial interest in the SPE's activities, even though it may own little or none of the SPE's equity.
4. IAS 27 requires the consolidation of entities that are controlled by the reporting enterprise. However, the standard does not provide explicit guidance on the consolidation of SPEs.
5. The issue is under what circumstances an enterprise should consolidate an SPE.
6. This interpretation does not apply to post-employment benefit plans or equity compensation plans.
7. A transfer of assets from an enterprise to an SPE may qualify as a sale by that enterprise. Even if the transfer does qualify as a sale, the provisions of IAS 27 and this interpretation may mean that the enterprise should consolidate the SPE. This interpretation does not address the circumstances in which sale treatment should apply for the enterprise or the elimination of the consequences of such a sale upon consolidation.

Consensus

8. An SPE should be consolidated when the substance of the relationship between an enterprise and the SPE indicates that the SPE is controlled by that enterprise.
9. In the context of an SPE, control may arise through the predetermination of the activities of the SPE (operating on 'autopilot') or otherwise. IAS 27.12 indicates several circumstances which result in control even in cases where an enterprise owns one half or less of the voting power of another enterprise. Similarly, control may exist even in cases where an enterprise owns little or none of the SPE's equity. The application of the control concept requires, in each case, judgement in the context of all relevant factors.
10. In addition to the situations described in IAS 27.12, the following circumstances, for example, may indicate a relationship in which an enterprise controls an SPE and consequently should consolidate the SPE (additional guidance is provided in the appendix to this interpretation):
 - (a) in substance, the activities of the SPE are being conducted on behalf of the enterprise according to its specific business needs so that the enterprise obtains benefits from the SPE's operation;
 - (b) in substance, the enterprise has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an 'autopilot' mechanism, the enterprise has delegated these decision making powers;

- (c) in substance, the enterprise has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incident to the activities of the SPE; or
 - (d) in substance, the enterprise retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.
11. Predetermination of the ongoing activities of an SPE by an enterprise (the sponsor or other party with a beneficial interest) would not represent the type of restrictions referred to in IAS 27.13(b).

Date of consensus: June 1998.

Effective date: This interpretation becomes effective for annual financial periods beginning on or after 1 July 1999; earlier application is encouraged. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-13

Jointly controlled entities — non-monetary contributions by venturers

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Reference: IAS 31 (revised 1998), financial reporting of interests in joint ventures.

Issue

1. IAS 31.39 (revised 1998) refers to both contributions and sales between a venturer and a joint venture as follows: 'When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction should reflect the substance of the transaction'. In addition, IAS 31.19 (revised 1998) says that 'a jointly controlled entity is a joint venture which involves the establishment of a corporation, partnership or other entity in which each venturer has an interest'. There is no explicit guidance on the recognition of gains and losses resulting from contributions of non-monetary assets to jointly controlled entities ('JCEs').
2. Contributions to a JCE are transfers of assets by venturers in exchange for an equity interest in the JCE. Such contributions may take various forms. Contributions may be made simultaneously by the venturers either upon establishing the JCE or subsequently. The consideration received by the venturer(s) in exchange for assets contributed to the JCE may also include cash or other consideration that does not depend on future cash flows of the JCE ('additional consideration').
3. The issues are:
 - (a) when the appropriate portion of gains or losses resulting from a contribution of a non-monetary asset to a JCE in exchange for an equity interest in the JCE should be recognised by the venturer in the income statement;
 - (b) how additional consideration should be accounted for by the venturer; and
 - (c) how any unrealised gain or loss should be presented in the consolidated financial statements of the venturer.

SIC-14

4. This interpretation deals with the venturer's accounting for non-monetary contributions to a JCE in exchange for an equity interest in the JCE that is accounted for using either the equity method or proportionate consolidation.

Consensus

5. In applying IAS 31.39 to non-monetary contributions to a JCE in exchange for an equity interest in the JCE, a venturer should recognise in the income statement for the period the portion of a gain or loss attributable to the equity interests of the other venturers except when:
- (a) the significant risks and rewards of ownership of the contributed non-monetary asset(s) have not been transferred to the JCE;
 - (b) the gain or loss on the non-monetary contribution cannot be measured reliably; or
 - (c) the non-monetary assets contributed are similar to those contributed by the other venturers. Non-monetary assets are similar to those contributed by other venturers when they have a similar nature, a similar use in the same line of business and a similar fair value. A contribution meets the similarity test only if all of the significant component assets thereof are similar to those contributed by the other venturers.

Where any of the exceptions (a) through (c) applies, the gain or loss would be considered unrealised and would therefore not be recognised in the income statement unless paragraph 6 also applies.

6. If, in addition to receiving an equity interest in the JCE, a venturer receives monetary or non-monetary assets dissimilar to those it contributed, an appropriate portion of gain or loss on the transaction should be recognised by the venturer in the income statement.
7. Unrealised gains or losses on non-monetary assets contributed to JCEs should be eliminated against the underlying assets under the proportionate consolidation method or against the investment under the equity method. Such unrealised gains or losses should not be presented as deferred gains or losses in the venturer's consolidated balance sheet.

Date of consensus: June 1998.

Effective date: this interpretation becomes effective for annual financial periods beginning on or after 1 January 1999; earlier application is encouraged. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-14**Property, plant and equipment — compensation for the impairment or loss of items**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Reference: IAS 16, property, plant and equipment (revised 1998).

Issue

1. Enterprises may receive monetary or non-monetary compensation from third parties for the impairment or loss of items of property, plant and equipment. Often the monetary compensation received has to be used for compelling economic reasons to restore impaired assets or to purchase or construct new assets in order to replace the assets lost or given up. IAS 16 (revised 1998) does not give explicit guidance on how to account for such monetary or non-monetary compensation.
2. Examples of such cases may include:
 - (a) reimbursement by insurance companies after an impairment or loss of items of property, plant and equipment, for example, due to natural disasters, theft or mishandling;
 - (b) indemnities by the government for items of property, plant and equipment that were expropriated, for example, land that has to be used for public purposes;
 - (c) compensation related to the involuntary conversion of items of property, plant and equipment, for example, relocation of facilities from a designated urban area to a non-urban area in accordance with a national land policy; or
 - (d) physical replacement in whole or in part of an impaired or lost asset.
3. The issue is how an enterprise should account for:
 - (a) impairments or losses of items of property, plant and equipment;
 - (b) related compensation from third parties, and
 - (c) subsequent restoration, purchase or construction of assets.

Consensus

4. Impairments or losses of items of property, plant and equipment, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and should be accounted for as such. The three economic events should be accounted for separately as follows:
 - (a) impairments of items of property, plant and equipment should be recognised under IAS 36; the retirement or disposal of items of property, plant and equipment should be recognised under IAS 16 (revised 1998);
 - (b) monetary or non-monetary compensation from third parties for items of property, plant and equipment that were impaired, lost or given up should be included in the income statement when recognised; and
 - (c) the cost of assets restored, purchased, constructed as a replacement, or received as compensation should be determined and presented under IAS 16 (revised 1998).

Disclosure

5. Monetary or non-monetary compensation recognised for the impairment or loss of items of property, plant and equipment should be disclosed separately.

Date of consensus: June 1998.

Effective date: this interpretation becomes effective for annual financial periods beginning on or after 1 July 1999; earlier application is encouraged. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

SIC-15/SIC-18**STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-15****Operating leases — incentives**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Reference: IAS 17, leases (revised 1997).

Issue

1. In negotiating a new or renewed operating lease, the lessor may provide incentives for the lessee to enter into the agreement. Examples of such incentives are an up-front cash payment to the lessee or the reimbursement or assumption by the lessor of costs of the lessee (such as relocation costs, leasehold improvements and costs associated with a pre-existing lease commitment of the lessee). Alternatively, initial periods of the lease term may be agreed to be rent-free or at a reduced rent.
2. The issue is how incentives in an operating lease should be recognised in the financial statements of both the lessee and the lessor.

Consensus

3. All incentives for the agreement of a new or renewed operating lease should be recognised as an integral part of the net consideration agreed for the use of the leased asset, irrespective of the incentive's nature or form or the timing of payments.
4. The lessor should recognise the aggregate cost of incentives as a reduction of rental income over the lease term, on a straight-line basis unless another systematic basis is representative of the time pattern over which the benefit of the leased asset is diminished.
5. The lessee should recognise the aggregate benefit of incentives as a reduction of rental expense over the lease term, on a straight-line basis unless another systematic basis is representative of the time pattern of the lessee's benefit from the use of the leased asset.
6. Costs incurred by the lessee, including costs in connection with a pre-existing lease (for example costs for termination, relocation or leasehold improvements), should be accounted for by the lessee in accordance with the International Accounting Standards applicable to those costs, including costs which are effectively reimbursed through an incentive arrangement.

Date of consensus: June 1998.

Effective date: this interpretation becomes effective for lease terms beginning on or after 1 January 1999.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-18**Consistency — alternative methods**

Paragraph 11 of IAS 1 (revised 1997), presentations of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not expected to apply to immaterial items.

Reference: IAS 1 (revised 1997), presentation of financial statements.

Issue

1. Certain IASC Standards provide an enterprise with an explicit choice between alternative accounting policies applied in preparing its financial statements. Some standards which provide explicit choice of an accounting policy indicate the manner in which that choice is to be exercised. For example, IAS 39.104 indicates that an enterprise should choose one of two policies for the recognition of changes in the fair value of available-for-sale financial assets, and should apply the policy selected to all available-for-sale financial assets. Other standards are silent on the manner of exercising choice.
2. The issue is how the choice of accounting policy should be exercised in the context of those IASC Standards which allow an explicit choice of accounting policy but are silent on the manner of exercising that choice. The fundamental question is whether, once a choice of policy is made, that policy should be followed consistently for all items accounted for under the specific requirements which provide the choice.

Consensus

3. If more than one accounting policy is available under an International Accounting Standard or Interpretation, an enterprise should choose and apply consistently one of those policies, unless the standard or interpretation specifically requires or permits categorisation of items (transactions, events, balances, amounts, etc.) for which different policies may be appropriate. If a standard requires or permits categorisation of items, the most appropriate accounting policy should be selected and applied consistently to each category. (Additional guidance is provided in Appendix A and Appendix B to this interpretation.)
4. Once the appropriate initial policy has been selected under the requirements of paragraph 3, a change in accounting policy should only be made in accordance with IAS 8.42 and applied to all items or categories of items in the manner specified in paragraph 3.

Date of consensus: May 1999.

Effective date: This interpretation becomes effective for annual financial periods beginning on or after 1 July 2000. Earlier application is encouraged. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-19**Reporting currency — measurement and presentation of financial statements under IAS 21 and IAS 29**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not expected to apply to immaterial items.

References: IAS 21, the effects of changes in foreign exchange rates (revised 1993) and IAS 29, financial reporting in hyperinflationary economies (reformatted 1994) (1).

Issue

1. Paragraph 4 of IAS 21 states that while that Standard does not specify the currency in which an enterprise presents its financial statements, an enterprise normally uses the currency of the country in which it is domiciled. While IAS 21 defines the term 'reporting currency' as the currency used in presenting the financial statements, the reporting currency used by an enterprise also has significant implications for accounting measurement in the financial statements.

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

SIC-19

2. IAS 21.7 defines a foreign currency as a currency other than the reporting currency of an enterprise. Therefore, the selection of a reporting currency establishes that all other currencies are treated as foreign currencies. Procedures for accounting for foreign currency transactions and translating financial statements of foreign operations are specified in IAS 21. IAS 21.36 indicates additional consequences of selecting a reporting currency for a foreign entity that reports in the currency of a hyperinflationary economy. The financial statements of such a foreign entity are restated under IAS 29 before they are translated into the reporting currency of the reporting enterprise. IAS 29.8 also requires restatement by an enterprise that presents its own financial statements using the currency of a hyperinflationary economy as its reporting currency.
3. The issues are:
 - (a) how an enterprise determines a currency for measuring items in its financial statements (the 'measurement currency');
 - (b) whether an enterprise may use a currency other than the measurement currency for presenting its financial statements (the 'presentation currency'); and
 - (c) if the presentation currency may be different from the measurement currency, then how the financial statements should be translated from the measurement currency to the presentation currency.
4. IAS 21.5 states that the restatement of an enterprise's financial statements from the currency in which it presents its financial statements in compliance with IAS into another currency for the convenience of users accustomed to that currency or for similar purposes is not dealt with by IAS 21. As a result, such restatements are not addressed in this Interpretation.

Consensus

5. The measurement currency should provide information about the enterprise that is useful and reflects the economic substance of the underlying events and circumstances relevant to that enterprise. If a particular currency is used to a significant extent in, or has a significant impact on, the enterprise, that currency may be an appropriate currency to be used as the measurement currency (additional guidance is provided in Appendix A to this interpretation). All transactions in currencies other than the measurement currency should be treated as transactions in foreign currencies when applying IAS 21.
6. Once the measurement currency has been selected, it should not be changed unless there is a change in the underlying events and circumstances relevant to that enterprise as determined in accordance with paragraph 5 of this interpretation.
7. If the measurement currency, determined in accordance with paragraph 5 of this Interpretation, is the currency of a hyperinflationary economy, then:
 - (a) the enterprise's own financial statements should be restated under IAS 29; and
 - (b) when the enterprise is a foreign entity as defined in IAS 21 and is included in the financial statements of another reporting enterprise, its financial statements should be restated under IAS 29 before being translated into the reporting currency of the other reporting enterprise.
8. If the currency of a country that does not have a hyperinflationary economy is determined to be an appropriate measurement currency under paragraph 5 of this interpretation, the enterprise is not required to restate its financial statements under IAS 29.
9. Although an enterprise normally presents its financial statements in the same currency as the measurement currency determined under paragraph 5 of this interpretation, it may choose to present its financial statements in a different currency. The method of translating the financial statements of a reporting enterprise from the measurement currency to a different currency for presentation is not specified under International Accounting Standards. However, for financial statements to present fairly the financial position, financial performance and cash flows, the translation method applied by an enterprise should not lead to reporting in a manner that is inconsistent with the measurement of items in the financial statements using the currency determined in accordance with paragraph 5 of this interpretation. In the case of an enterprise that has foreign entities and presents consolidated financial statements, the currency used in presenting the consolidated financial statements is normally the same as the parent's measurement currency but will often differ from the measurement currencies used by individual foreign entities. (Appendix B provides an illustration of application of this interpretation to consolidated financial statements.)

Disclosure

10. The following should be disclosed:

- (a) when the measurement currency is different from the currency of the country in which the enterprise is domiciled, the reason for using a different currency;
- (b) the reason for any change in the measurement currency or presentation currency; and
- (c) when the financial statements are presented in a currency different from the enterprise's measurement currency, the measurement currency, the reason for using a different presentation currency, and a description of the method used in the translation process.

In consolidated financial statements, the references to measurement currency for the purpose of these disclosure requirements are to the measurement currency of the parent.

Date of consensus: February 2000.

Effective date: This interpretation becomes effective for annual financial periods beginning on or after 1 January 2001. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-20**Equity accounting method — recognition of losses**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Reference: IAS 28, accounting for investments in associates (revised 1998).

Issue

1. In some situations, an investor may hold a variety of financial interests in an associate or joint venture that is accounted for under the equity method. For example, the investor may hold financial interests including ordinary or preferred shares, loans, advances, debt securities, options to acquire ordinary shares, or trade receivables.
2. IAS 28.22 indicates that in applying the equity method, once the investor's share of losses of an associate equals or exceeds the carrying amount of an investment, the investor normally discontinues including its share of further losses in its income statement. However, 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.
3. In applying the equity method, the issues are:
 - (a) which financial interests are included in the 'carrying amount of an investment' referred to in IAS 28.22; and
 - (b) whether recognition of the entity's share of losses of the associate or jointly controlled entity (investee) in excess of the carrying amount of the investment is continued when the enterprise holds other financial interests in the investee which are not included in the carrying amount of the investment.

SIC-21

4. This interpretation addresses the application of the equity method under IAS 28. Under the allowed alternative treatment permitted by IAS 31.32, an enterprise applies the equity method in reporting its interest in a jointly controlled entity and therefore also applies this interpretation.

Consensus

5. Financial interests may be described in a variety of ways, for example, some interests are described as ordinary shares or as preferred shares. For the purpose of applying IAS 28.22, the carrying amount of an investment should include only the carrying amount of instruments which provide unlimited rights of participation in earnings or losses and a residual equity interest in the investee.
6. If the investor's share of losses exceeds the carrying amount of the investment, the carrying amount of the investment is reduced to nil and recognition of further losses should be discontinued, unless the investor has incurred obligations to the investee or to satisfy obligations of the investee that the investor has guaranteed or otherwise committed, whether funded or not. To the extent that the investor has incurred such obligations, the investor continues to recognise its share of losses of the investee.
7. Financial interests in an investee which are not included in the carrying amount of the investment under paragraph 5 of this interpretation are accounted for in accordance with other applicable International Accounting Standards, for example, IAS 39, and prior to the implementation of IAS 39, IAS 25 (reformatted 1994).
8. Continuing losses of an investee should be considered objective evidence that financial interests in that investee, both financial interests which are included in the carrying amount of an investment under paragraph 5 of this interpretation and other financial interests, may be impaired. Impairment of the carrying amount of a financial interest which is included in the carrying amount of an asset is determined based on the carrying amount after any adjustment for equity method losses.
9. If the investor has guaranteed or is otherwise committed to obligations to the investee or to satisfying obligations of the investee, in addition to continuing to recognise its share of losses of the investee, the investor should determine whether a provision should be recognised in accordance with IAS 37. (Prior to the application of IAS 37, the recognition of a provision is evaluated under the requirements of IAS 10 (reformatted 1994).)

Disclosure

10. If an investor discontinues recognition of its share of losses of an investee, the investor should disclose in the notes to the financial statements the amount of its unrecognised share of losses of the investee, both during the period and cumulatively.

Date of consensus: August 1999.

Effective date: This interpretation becomes effective on 15 July 2000. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-21**Income taxes — recovery of revalued non-depreciable assets**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

SIC-22

Draft interpretation SIC-D21, income taxes — omnibus was issued for comment in September 1999. The draft interpretation included both the issue addressed in this interpretation and the issue included in interpretation SIC-25, income taxes — changes in the tax status of an enterprise or its shareholders.

Reference: IAS 12, income taxes (revised 1996).

Issue

1. Under IAS 12.51, the measurement of deferred tax liabilities and assets should reflect the tax consequences that would follow from the manner in which the enterprise expects, at the balance sheet date, to recover or settle the carrying amount of those assets and liabilities that give rise to temporary differences.
2. IAS 12.20 notes that the revaluation of an asset does not always affect taxable profit (tax loss) in the period of the revaluation and that the tax base of the asset may not be adjusted as a result of the revaluation. If the future recovery of the carrying amount will be taxable, any difference between the carrying amount of the revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset.
3. The issue is how to interpret the term 'recovery' in relation to an asset that is not depreciated (non-depreciable asset) and is revalued under paragraph 29 of IAS 16 (revised 1998).
4. This interpretation also applies to investment properties which are carried at revalued amounts under IAS 25.23(b) but would be considered non-depreciable if IAS 16 were to be applied.

Consensus

5. The deferred tax liability or asset that arises from the revaluation of a non-depreciable asset under IAS 16.29 should be measured based on the tax consequences that would follow from recovery of the carrying amount of that asset through sale, regardless of the basis of measuring the carrying amount of that asset. Accordingly, if the tax law specifies a tax rate applicable to the taxable amount derived from the sale of an asset that differs from the tax rate applicable to the taxable amount derived from using an asset, the former rate is applied in measuring the deferred tax liability or asset related to a non-depreciable asset.

Date of consensus: August 1999.

Effective date: This consensus becomes effective on 15 July 2000. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-22**Business combinations — subsequent adjustment of fair values and goodwill initially reported**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Reference: IAS 22 (revised 1998), business combinations.

SIC-22*Issue*

1. In initially accounting for a business combination, an acquirer may not have available all evidence to be able to identify and to estimate reliably the fair values of the assets and liabilities acquired or the identifiable assets and liabilities may not yet satisfy the criteria for recognition. This may be due to the complexity of the business acquired, the need to produce and report financial information on a timely basis, or for other reasons.
2. IAS 22.71 (revised 1998) indicates that in accounting for a business acquisition, identifiable assets and liabilities, which are acquired but do not satisfy the criteria ... 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
 - (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.

3. The issues are, in making adjustments in the limited circumstances described by IAS 22.71:
 - (a) whether an adjustment to the initial fair values of identifiable assets and liabilities acquired should include the effects of depreciation and other changes which would have resulted if the adjusted fair values had been applied from the date of acquisition;
 - (b) whether a related adjustment of goodwill or negative goodwill should include the effect of amortisation of the adjusted amount assigned to goodwill or negative goodwill from the date of acquisition; and
 - (c) how the adjustments to identifiable assets and liabilities acquired, and to goodwill or negative goodwill, should be presented.
4. This interpretation does not apply to the following items as they are specifically addressed elsewhere in International Accounting Standards:
 - (a) deferred tax assets and liabilities recognised under IAS 12 (revised 1996), paragraphs 66 through 68; and
 - (b) the reversal of provisions initially made for terminating or reducing the activities of the acquiree, IAS 22 (revised 1998), paragraphs 75 and 76.

Consensus

5. An adjustment to the carrying amount of identifiable assets and liabilities acquired, made in the limited circumstances described under IAS 22.71, should be calculated as if the adjusted fair values had been applied from the date of acquisition. As a result, the adjustment should include both the effect of the change to the fair values initially assigned and the effect of depreciation and other changes which would have resulted if the adjusted fair values had been applied from the date of acquisition.
6. If the adjustment to identifiable assets and liabilities is made by the end of the first annual accounting period commencing after acquisition, the carrying amount of goodwill or negative goodwill should also be adjusted, when necessary, to the amount which would have been determined if the adjusted fair values had been available at the date of acquisition. As a result, goodwill amortisation or recognition of negative goodwill is also adjusted from the date of acquisition. However, an adjustment to the carrying amount of goodwill should be made only to the extent that it does not increase the carrying amount of goodwill above its recoverable amount.

7. Adjustments to depreciation and amortisation, impairment charges, and other amounts, determined under paragraphs 5 and 6 of this interpretation, should be included in net profit or loss in the respective classification of income or expense presented on the face of the income statement. Only items subsequent to the acquisition date which are required or are permitted to be credited or charged directly to equity under other standards would be recognised in equity; this interpretation does not alter the treatment under those other standards.

Disclosure

8. Adjustments to the carrying amounts of identifiable assets or liabilities or goodwill or negative goodwill should be disclosed and explained in the financial statements of the period in which the adjustment is made. The amount of an adjustment which relates to prior and comparative periods should also be disclosed.

Date of consensus: October 1999.

Effective date: This interpretation becomes effective for adjustments made in annual periods ending on or after 15 July 2000.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-23

Property, plant and equipment — major inspection or overhaul costs

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not expected to apply to immaterial items.

Reference: IAS 16, property, plant and equipment (revised 1998).

Issue

1. IAS 16.23 (revised 1998) requires the capitalisation of subsequent expenditure on an item of plant, property or equipment that improves the condition of the asset beyond its originally assessed standard of performance. All other subsequent expenditure, such as repairs or maintenance expenditure that restores or maintains the future economic benefits that an enterprise can expect from the originally assessed standard of performance of the asset, should be recognised as an expense in the period in which it is incurred.
2. IAS 16.27 indicates that major components of some items of property, plant and equipment may require replacement at regular intervals. The components are accounted for as separate assets because they have useful lives different from those of the items of property, plant and equipment to which they relate.
3. An enterprise purchases a property, plant and equipment asset and incurs all costs necessary to bring it into condition for its intended use. The enterprise will in the future need to perform a major inspection or overhaul of the asset at regular intervals over its useful life to allow the continued use of the asset by the enterprise. An example of this is the purchase of an aircraft which requires an overhaul once every three years.
4. The issue is when the enterprise incurs the cost of the major inspections or overhauls of the item of property, plant or equipment, occurring at regular intervals over the useful life of the asset and made to allow the continued use of the asset by the enterprise, should those costs be capitalised as a component of the asset or expensed.

SIC-24*Consensus*

5. The cost of a major inspection or overhaul of an item of property, plant and equipment occurring at regular intervals over the useful life of an asset and made to allow the continued use of the asset should be recognised as an expense in the period in which it is incurred except when:
 - (a) consistent with IAS 16.12, the enterprise has identified as a separate component of the asset an amount representing major inspection or overhaul and has already depreciated that component to reflect the consumption of benefits which are replaced or restored by the subsequent major inspection or overhaul (whether the asset is carried at historical cost or revalued);
 - (b) it is probable that future economic benefits associated with the asset will flow to the enterprise; and
 - (c) the cost of the major inspection or overhaul to the enterprise can be measured reliably.

If these criteria are met, the cost should be capitalised and accounted for as a component of the asset.

Date of consensus: October 1999.

Effective date: This interpretation becomes effective on 15 July 2000. Implementation of the components approach described in this interpretation is a change in the method of depreciation and is treated as a change in accounting estimate, consistent with IAS 16.52. As a result, the depreciation charge for the current and future periods is adjusted.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-24**Earnings per share — financial instruments and other contracts that may be settled in shares**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not expected to apply to immaterial items.

Reference: IAS 33, earnings per share.

Issue

1. There are various forms of financial instruments or other contracts that may be settled by a reporting enterprise either by payment of financial assets or by payment in the form of a transfer of ordinary shares of the reporting enterprise to the holder. In some cases, the manner of settlement is chosen by the issuer of the financial instrument and in other cases the manner of settlement is chosen by the holder of the financial instrument. An example of this type of instrument is a contractual obligation of the reporting enterprise that may be settled by payment of cash or issuance of ordinary shares of the reporting enterprise.
2. The issue is whether financial instruments or other contracts that may be settled by payment of financial assets or issuance of ordinary shares of the reporting enterprise, at the option of the issuer or the holder, are potential ordinary shares under IAS 33.
3. This interpretation addresses contracts that specify such alternative settlement methods in their terms.

Consensus

4. All financial instruments or other contracts that may result in the issuance of ordinary shares of the reporting enterprise to the holder of the financial instrument or other contract, at the option of the issuer or the holder, are potential ordinary shares of the enterprise.

Date of consensus: February 2000.

Effective date: this interpretation becomes effective on 1 December 2000. Comparative information presented and disclosed in financial statements under IAS 33.47-52 should be restated for the effect of applying this interpretation.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-25**Income taxes — changes in the tax status of an enterprise or its shareholders**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not intended to apply to immaterial items.

Draft interpretation SIC-D21, income taxes — omnibus was issued for comment in September 1999. The draft interpretation included both the issue addressed in this interpretation and the issue included in interpretation SIC-21, income taxes — recovery of revalued non-depreciable assets.

Reference: IAS 12, income taxes (revised 1996).

Issue

1. A change in the tax status of an enterprise or of its shareholders may have consequences for an enterprise by increasing or decreasing its tax liabilities or assets. This may, for example, occur upon the public listing of an enterprise's equity instruments or upon the restructuring of an enterprise's equity. It may also occur upon a controlling shareholder's move to a foreign country. As a result of such an event, an enterprise may be taxed differently; it may for example gain or lose tax incentives or become subject to a different rate of tax in the future.
2. A change in the tax status of an enterprise or its shareholders may have an immediate effect on the enterprise's current tax liabilities or assets. The change may also increase or decrease the deferred tax liabilities and assets recognised by the enterprise, depending on the effect the change in tax status has on the tax consequences that will arise from recovering or settling the carrying amount of the enterprise's assets and liabilities.
3. The issue is how an enterprise should account for the tax consequences of a change in its tax status or that of its shareholders.

Consensus

4. A change in the tax status of an enterprise or its shareholders does not give rise to increases or decreases in amounts recognised directly in equity. The current and deferred tax consequences of a change in tax status should be included in net profit or loss for the period, unless those consequences relate to transactions and events that result, in the same or a different period, in a direct credit or charge to the recognised amount of equity. Those tax consequences that relate to changes in the recognised amount of equity, in the same or a different period (not included in net profit or loss), should be charged or credited directly to equity.

SIC-27

Date of consensus: August 1999.

Effective date: this consensus becomes effective on 15 July 2000. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-27**Evaluating the substance of transactions involving the legal form of a lease**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not expected to apply to immaterial items.

References: IAS 1, presentation of financial statements (revised 1997), IAS 17, leases (revised 1997), IAS 18, revenue (revised 1993).

Issue

1. An enterprise may enter into a transaction or a series of structured transactions (an arrangement) with an unrelated party or parties (an investor) that involves the legal form of a lease. For example, an enterprise may lease assets to an investor and lease the same assets back, or alternatively, legally sell assets and lease the same assets back. The form of each arrangement and its terms and conditions can vary significantly. In the lease and leaseback example, it may be that the arrangement is designed to achieve a tax advantage for the investor that is shared with the enterprise in the form of a fee, and not to convey the right to use an asset.
2. When an arrangement with an investor involves the legal form of a lease, the issues are:
 - (a) how to determine whether a series of transactions is linked and should be accounted for as one transaction;
 - (b) whether the arrangement meets the definition of a lease under IAS 17; and, if not,
 - (i) whether a separate investment account and lease payment obligations that might exist represent assets and liabilities of the enterprise (e.g. consider the example described in paragraph 2(a) of Appendix A);
 - (ii) how the enterprise should account for other obligations resulting from the arrangement; and
 - (iii) how the enterprise should account for a fee it might receive from an investor.

Consensus

3. A series of transactions that involve the legal form of a lease is linked and should be accounted for as one transaction when the overall economic effect cannot be understood without reference to the series of transactions as a whole. This is the case, for example, when the series of transactions are closely interrelated, negotiated as a single transaction, and takes place concurrently or in a continuous sequence. (Appendix A provides illustrations of application of this interpretation.)

4. The accounting should reflect the substance of the arrangement. All aspects and implications of an arrangement should be evaluated to determine its substance, with weight given to those aspects and implications that have an economic effect.
5. IAS 17 applies when the substance of an arrangement includes the conveyance of the right to use an asset for an agreed period of time. Indicators that individually demonstrate that an arrangement may not, in substance, involve a lease under IAS 17 include (Appendix B provides illustrations of application of this interpretation):
 - (a) an enterprise retains all the risks and rewards incident to ownership of an underlying asset and enjoys substantially the same rights to its use as before the arrangement;
 - (b) the primary reason for the arrangement is to achieve a particular tax result, and not to convey the right to use an asset; and
 - (c) an option is included on terms that make its exercise almost certain (e.g. a put option that is exercisable at a price sufficiently higher than the expected fair value when it becomes exercisable).
6. The definitions and guidance in paragraphs 49 to 64 of the framework should be applied in determining whether, in substance, a separate investment account and lease payment obligations represent assets and liabilities of the enterprise. Indicators that collectively demonstrate that, in substance, a separate investment account and lease payment obligations do not meet the definitions of an asset and a liability and should not be recognised by the enterprise include:
 - (a) the enterprise is not able to control the investment account in pursuit of its own objectives and is not obligated to pay the lease payments. This occurs when, for example, a prepaid amount is placed in a separate investment account to protect the investor and may only be used to pay the investor, the investor agrees that the lease payment obligations are to be paid from funds in the investment account, and the enterprise has no ability to withhold payments to the investor from the investment account;
 - (b) the enterprise has only a remote risk of reimbursing the entire amount of any fee received from an investor and possibly paying some additional amount, or, when a fee has not been received, only a remote risk of paying an amount under other obligations (e.g. a guarantee). Only a remote risk of payment exists when, for example, the terms of the arrangement require that a prepaid amount is invested in risk-free assets that are expected to generate sufficient cash flows to satisfy the lease payment obligations; and
 - (c) other than the initial cash flows at inception of the arrangement, the only cash flows expected under the arrangement are the lease payments that are satisfied solely from funds withdrawn from the separate investment account established with the initial cash flows.
7. Other obligations of an arrangement, including any guarantees provided and obligations incurred upon early termination, should be accounted for under IAS 37 or IAS 39, depending on the terms.
8. The criteria in paragraph 20 of IAS 18 should be applied to the facts and circumstances of each arrangement in determining when to recognise a fee as income that an enterprise might receive. Factors such as whether there is continuing involvement in the form of significant future performance obligations necessary to earn the fee, whether there are retained risks, the terms of any guarantee arrangements, and the risk of repayment of the fee, should be considered. Indicators that individually demonstrate that recognition of the entire fee as income when received, if received at the beginning of the arrangement, is inappropriate include:
 - (a) obligations either to perform or to refrain from certain significant activities are conditions of earning the fee received, and therefore execution of a legally binding arrangement is not the most significant act required by the arrangement;
 - (b) limitations are put on the use of the underlying asset that have the practical effect of restricting and significantly changing the enterprise's ability to use (e.g. deplete, sell or pledge as collateral) the asset;

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- (c) the possibility of reimbursing any amount of the fee and possibly paying some additional amount is not remote. This occurs when, for example:
 - (i) the underlying asset is not a specialised asset that is required by the enterprise to conduct its business, and therefore there is a possibility that the enterprise may pay an amount to terminate the arrangement early; or
 - (ii) the enterprise is required by the terms of the arrangement, or has some or total discretion, to invest a prepaid amount in assets carrying more than an insignificant amount of risk (e.g. currency, interest rate or credit risk). In this circumstance, the risk of the investment's value being insufficient to satisfy the lease payment obligations is not remote, and therefore there is a possibility that the enterprise may be required to pay some amount.
9. The fee should be presented in the income statement based on its economic substance and nature.

Disclosure

10. All aspects of an arrangement that does not, in substance, involve a lease under IAS 17 should be considered in determining the appropriate disclosures that are necessary to understand the arrangement and the accounting treatment adopted. An enterprise should disclose the following in each period that an arrangement exists:
- (a) a description of the arrangement including:
 - (i) the underlying asset and any restrictions on its use;
 - (ii) the life and other significant terms of the arrangement;
 - (iii) the transactions that are linked together, including any options; and
 - (b) the accounting treatment applied to any fee received, the amount recognised as income in the period, and the line item of the income statement in which it is included.
11. The disclosures required in accordance with paragraph 10 of this interpretation should be provided individually for each arrangement or in aggregate for each class of arrangement. A class is a grouping of arrangements with underlying assets of a similar nature (e.g. power plants).

Date of consensus: February 2000.

Effective date: this interpretation becomes effective on 31 December 2001. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-28**Business combinations — 'date of exchange' and fair value of equity instruments**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not expected to apply to immaterial items.

Reference: IAS 22, business combinations (revised 1998).

Issue

1. An enterprise may issue its own equity instruments as purchase consideration in a business combination accounted for as an acquisition under IAS 22. IAS 22.21 requires that an acquisition be accounted for at its cost, and that equity instruments issued by the acquirer be measured at their fair value at the date of exchange.
2. If equity instruments issued as purchase consideration are quoted in a market and their market price at the date of exchange is not a reliable indicator of their fair value, IAS 22.24 indicates that price movements for a reasonable period before and after the announcement of the terms of the acquisition need to be considered.
3. The issues are:
 - (a) what is the 'date of exchange' when determining the fair value of equity instruments issued as purchase consideration in an acquisition;
 - (b) when is it appropriate to consider other evidence and valuation methods in addition to a published price at the date of exchange of a quoted equity instrument; and
 - (c) what information should be disclosed when a published price of a quoted equity instrument has not been used as the instruments' fair value, and what information should be disclosed when an equity instrument does not have a published price.
4. IAS 22.65 requires the amount of an adjustment to the purchase consideration contingent on one or more future events to be included in the cost of an acquisition as at the date of acquisition if the adjustment is probable and the amount can be measured reliably. IAS 22.68 requires the cost of an acquisition to be adjusted when a contingency affecting the amount of the purchase consideration is resolved subsequent to the date of acquisition. Consequently, this interpretation does not apply to equity instruments issued as adjustments to the purchase consideration contingent on one or more future events, unless the adjustments are probable and the amounts can be measured reliably as at the date of acquisition.

Consensus

5. When an acquisition is achieved in one exchange transaction (i.e. not in stages), the 'date of exchange' is the date of acquisition; that is, the date when the acquirer obtains control over the net assets and operations of the acquiree. When an acquisition is achieved in stages (e.g. successive share purchases), the fair value of the equity instruments issued as purchase consideration at each stage should be determined at the date that each individual investment is recognised in the financial statements of the acquirer.
6. The published price at the date of exchange of a quoted equity instrument provides the best evidence of the instrument's fair value and should be used, except in rare circumstances. Other evidence and valuation methods should also be considered only in the rare circumstance when it can be demonstrated that the published price at that date is an unreliable indicator, and that the other evidence and valuation methods provide a more reliable measure of the equity instrument's fair value. The published price at the date of exchange is an unreliable indicator only when it has been affected by an undue price fluctuation or a narrowness of the market.

Disclosure

7. When a published price of an equity instrument issued as purchase consideration exists at the date of exchange, but has not been used as the instruments' fair value, an enterprise should disclose:
 - (a) that fact;
 - (b) the reasons why the published price is not the fair value of the equity instruments;

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- (c) the method and significant assumptions applied in determining the fair value; and
 - (d) the aggregate amount of the difference between the published price and the amount determined to be the fair value of the equity instruments.
8. When an equity instrument issued as purchase consideration does not have a published price at the date of exchange, an enterprise should disclose that fact and the method and significant assumptions applied in determining the fair value.

Date of consensus: February 2001.

Effective date: This interpretation becomes effective for acquisitions given initial accounting recognition on or after 31 December 2001.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-29**Disclosure — service concession arrangements**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not expected to apply to immaterial items.

Reference: IAS 1, presentation of financial statements (revised 1997).

Issue

1. An enterprise (the concession operator) may enter into an arrangement with another enterprise (the concession provider) to provide services that give the public access to major economic and social facilities. The concession provider may be a public or private sector enterprise, including a governmental body. Examples of service concession arrangements involve water treatment and supply facilities, motorways, car parks, tunnels, bridges, airports and telecommunication networks. Examples of arrangements that are not service concession arrangements include an enterprise outsourcing the operation of its internal services (e.g. employee cafeteria, building maintenance, and accounting or information technology functions).
2. A service concession arrangement generally involves the concession provider conveying for the period of the concession to the concession operator:
 - (a) the right to provide services that give the public access to major economic and social facilities, and
 - (b) in some cases, the right to use specified tangible assets, intangible assets, and/or financial assets,in exchange for the concession operator:
 - (a) committing to provide the services according to certain terms and conditions during the concession period, and
 - (b) when applicable, committing to return at the end of the concession period the rights received at the beginning of the concession period and/or acquired during the concession period.
3. The common characteristic of all service concession arrangements is that the concession operator both receives a right and incurs an obligation to provide public services.

4. The issue is what information should be disclosed in the notes to the financial statements of a concession operator and a concession provider.
5. Certain aspects and disclosures relating to some service concession arrangements are already addressed by existing International Accounting Standards (e.g. IAS 16 applies to acquisitions of items of property, plant and equipment, IAS 17 applies to leases of assets, and IAS 38 applies to acquisitions of intangible assets). However, a service concession arrangement may involve executory contracts that are not addressed in International Accounting Standards, unless the contracts are onerous, in which case IAS 37 applies. Therefore, this interpretation addresses additional disclosures of service concession arrangements.

Consensus

6. All aspects of a service concession arrangement should be considered in determining the appropriate disclosures in the notes to the financial statements. A concession operator and a concession provider should disclose the following in each period:
 - (a) a description of the arrangement;
 - (b) significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows (e.g. the period of the concession, repricing dates and the basis upon which repricing or renegotiation is determined);
 - (c) the nature and extent (e.g. quantity, time period or amount as appropriate) of:
 - (i) rights to use specified assets;
 - (ii) obligations to provide or rights to expect provision of services;
 - (iii) obligations to acquire or build items of property, plant and equipment;
 - (iv) obligations to deliver or rights to receive specified assets at the end of the concession period;
 - (v) renewal and termination options; and
 - (vi) other rights and obligations (e.g. major overhauls); and
 - (d) changes in the arrangement occurring during the period.
7. The disclosures required in accordance with paragraph 6 of this interpretation should be provided individually for each service concession arrangement or in aggregate for each class of service concession arrangements. A class is a grouping of service concession arrangements involving services of a similar nature (e.g. toll collections, telecommunications and water treatment services).

Date of consensus: May 2001.

Effective date: this interpretation becomes effective on 31 December 2001.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-30

Reporting currency — translation from measurement currency to presentation currency

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not expected to apply to immaterial items.

Reference: IAS 21, the effects of changes in foreign exchange rates (revised 1993), IAS 29, financial reporting in hyperinflationary economies (reformatted 1994).

SIC-30*Issue*

1. SIC-19, reporting currency — measurement and presentation of financial statements under IAS 21 and IAS 29, addresses the issue of how an enterprise translates its financial statements from a currency used for measuring items in its financial statements (measurement currency) to another currency for presentation purposes (presentation currency). SIC-19 does not specify the method of translation to be applied, but does require that the translation method used not lead to reporting in a manner that is inconsistent with the measurement of items in the financial statements.
2. SIC-19.15 elaborates on the requirement in the example of a Russian enterprise using the Russian rouble as an appropriate measurement currency and translating its financial statements to another currency (e.g. euro) for presentation. It states that the method applied to translate from Russian roubles to euro should not, for example, have the effect of substituting the euros for the Russian rouble as the measurement currency.
3. IAS 21.5 states that the 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.
4. The issues are:
 - (a) how items in financial statements should be translated from a measurement currency to a presentation currency when the financial statements are presented in a currency other than the measurement currency determined under SIC-19; and
 - (b) what information should be disclosed:
 - (i) when financial statements are presented in a currency other than the measurement currency determined under SIC-19; or
 - (ii) when additional information not required by International Accounting Standards is displayed in financial statements and in a currency, other than the currency used in presenting the financial statements, as a convenience to certain users.
5. This interpretation is to be read and applied in conjunction with the requirements of SIC-19. The term 'financial statements' encompasses consolidated financial statements as stated in IAS 27.4.

Consensus

6. When financial statements are presented in a currency other than the measurement currency determined under SIC-19, and the measurement currency is not the currency of a hyperinflationary economy, the requirements of SIC-19.9 should be applied as follows:
 - (a) assets and liabilities for all balance sheets presented (i.e. including comparatives) should be translated at the closing rate existing at the date of each balance sheet presented;
 - (b) income and expense items for all periods presented (i.e. including comparatives) should be translated at the exchange rates existing at the dates of the transactions or a rate that approximates the actual exchange rates;
 - (c) equity items other than the net profit or loss for the period that is included in the balance of accumulated profit or loss should be translated at the closing rate existing at the date of each balance sheet presented; and
 - (d) all exchange differences resulting from translation in accordance with paragraphs 6(a) to (c) of this interpretation should be recognised directly in equity.
7. When financial statements are presented in a currency other than the measurement currency determined under SIC-19, and the measurement currency is the currency of a hyperinflationary economy, the requirements of SIC-19.9 should be applied as follows:
 - (a) assets, liabilities and equity items for all balance sheets presented (i.e. including comparatives) should be translated at the closing rate existing at the date of the most recent balance sheet presented; and
 - (b) income and expense items for all periods presented (i.e. including comparatives) should be translated at the closing rate existing at the end of the most recent period presented.

Disclosure

8. When financial statements are presented in a currency other than the measurement currency determined under SIC-19, an enterprise should state the fact that the measurement currency reflects the economic substance of the underlying events and circumstances of the enterprise, in addition to disclosing the information required by SIC-19.10.
9. When financial statements are presented in a currency other than the measurement currency determined under SIC-19, and the measurement currency is the currency of a hyperinflationary economy, an enterprise should disclose the closing exchange rates between the measurement currency and the presentation currency existing at the date of each balance sheet presented, in addition to the disclosures required by IAS 29.39.
10. When additional information not required by International Accounting Standards is displayed in financial statements and in a currency, other than the currency used in presenting the financial statements, as a convenience to certain users, an enterprise should,
 - (a) clearly identify the information as supplementary information to distinguish it from the information required by International Accounting Standards and translated in accordance with paragraphs 6 or 7 of this interpretation (whichever is applicable),
 - (b) disclose the measurement currency used to prepare the financial statements and the method of translation used to determine the supplementary information displayed,
 - (c) disclose the fact that the measurement currency reflects the economic substance of the underlying events and circumstances of the enterprise and that the supplementary information is displayed in another currency for convenience purposes only, and
 - (d) disclose the currency in which the supplementary information is displayed.

The statement required by paragraphs 8 and 10(c) is required in consolidated financial statements in all circumstances other than when the measurement currencies of the enterprises in the group and the presentation currency, and when displaying additional information, the display currency, are the same. For the purpose of the disclosure requirements in paragraphs 9 and 10(b) in consolidated financial statements, the references to measurement currency are to the measurement currency of the parent.

Date of consensus: May 2001.

Effective date: this interpretation becomes effective for annual financial periods beginning on or after 1 January 2002. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-31**Revenue — barter transactions involving advertising services**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not expected to apply to immaterial items.

Reference: IAS 18, revenue (revised 1993).

Issue

1. An enterprise (seller) may enter into a barter transaction to provide advertising services in exchange for receiving advertising services from its customer (customer). Advertisements may be displayed on the Internet or poster sites, broadcast on the television or radio, published in magazines or journals, or presented in another medium.

SIC-32

2. In some cases, no cash or other consideration is exchanged between the enterprises. In some other cases, equal or approximately equal amounts of cash or other consideration are also exchanged.
3. A seller that provides advertising services in the course of its ordinary activities recognises revenue under IAS 18 from a barter transaction involving advertising when, amongst other criteria, the services exchanged are dissimilar (IAS 18.12) and the amount of revenue can be measured reliably (IAS 18.20(a)). This interpretation only applies to an exchange of dissimilar advertising services. An exchange of similar advertising services is not a transaction that generates revenue under IAS 18.
4. The issue is under what circumstances can a seller reliably measure revenue at the fair value of advertising services received or provided in a barter transaction.

Consensus

5. Revenue from a barter transaction involving advertising cannot be measured reliably at the fair value of advertising services received. However, a seller can reliably measure revenue at the fair value of the advertising services it provides in a barter transaction, by reference only to non-barter transactions that:
 - (a) involve advertising similar to the advertising in the barter transaction;
 - (b) occur frequently;
 - (c) represent a predominant number of transactions and amount when compared to all transactions to provide advertising that is similar to the advertising in the barter transaction;
 - (d) involve cash and/or another form of consideration (e.g. marketable securities, non-monetary assets, and other services) that has a reliably measurable fair value; and
 - (e) do not involve the same counterparty as in the barter transaction.

Date of consensus: May 2001.

Effective date: this interpretation becomes effective on 31 December 2001. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-32**Intangible assets — web site costs**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not expected to apply to immaterial items.

Reference: IAS 38, intangible assets.

Issue

1. An enterprise may incur internal expenditure on the development and operation of its own web site for internal or external access. A web site designed for external access may be used for various purposes such as to promote and advertise an enterprise's own products and services, provide electronic services, and sell products and services. A web site designed for internal access may be used to store company policies and customer details, and search relevant information.

2. The stages of a web site's development can be described as follows:
 - (a) planning — includes undertaking feasibility studies, defining objectives and specifications, evaluating alternatives and selecting preferences;
 - (b) application and infrastructure development — includes obtaining a domain name, purchasing and developing hardware and operating software, installing developed applications and stress testing;
 - (c) graphical design development — includes designing the appearance of web pages;
 - (d) content development — includes creating, purchasing, preparing and uploading information, either textual or graphical in nature, on the web site before the completion of the web site's development. This information may either be stored in separate databases that are integrated into (or accessed from) the web site or coded directly into the web pages.
3. Once development of a web site has been completed, the operating stage begins. During this stage, an enterprise maintains and enhances the applications, infrastructure, graphical design and content of the web site.
4. When accounting for internal expenditure on the development and operation of an enterprise's own web site for internal or external access, the issues are:
 - (a) whether the web site is an internally generated intangible asset that is subject to the requirements of IAS 38; and
 - (b) the appropriate accounting treatment of such expenditure.
5. This interpretation does not apply to expenditure on purchasing, developing, and operating hardware (e.g. web servers, staging servers, production servers and Internet connections) of a web site. Such expenditure is accounted for under IAS 16, property, plant and equipment (revised 1998). Additionally, when an enterprise incurs expenditure on an Internet service provider hosting the enterprise's web site, the expenditure is recognised as an expense under IAS 8.7 and the framework when the services are received.
6. IAS 38 does not apply to intangible assets held by an enterprise for sale in the ordinary course of business (see IAS 2, inventories, and IAS 11, construction contracts) or leases that fall within the scope of IAS 17, leases (revised 1997). Accordingly, this interpretation does not apply to expenditure on the development or operation of a web site (or web site software) for sale to another enterprise. When a web site is leased under an operating lease, the lessor applies this interpretation. When a web site is leased under a finance lease, the lessee applies this interpretation after initial recognition of the leased asset.

Consensus

7. An enterprise's own web site that arises from development and is for internal or external access is an internally generated intangible asset that is subject to the requirements of IAS 38.
8. A web site arising from development should be recognised as an intangible asset if, and only if, in addition to complying with the general requirements described in IAS 38.19 for recognition and initial measurement, an enterprise can satisfy the requirements in IAS 38.45. In particular, an enterprise may be able to satisfy the requirement to demonstrate how its web site will generate probable future economic benefits under IAS 38.45(d) when, for example, the web site is capable of generating revenues, including direct revenues from enabling orders to be placed. An enterprise is not able to demonstrate how a web site developed solely or primarily for promoting and advertising its own products and services will generate probable future economic benefits, and consequently all expenditure on developing such a web site should be recognised as an expense when incurred.

SIC-33

9. Any internal expenditure on the development and operation of an enterprise's own web site should be accounted for in accordance with IAS 38. The nature of each activity for which expenditure is incurred (eg training employees and maintaining the web site) and the web site's stage of development or post-development should be evaluated to determine the appropriate accounting treatment (additional guidance is provided in the appendix to this interpretation). For example:
- (a) the planning stage is similar in nature to the research phase in IAS 38.42 to 44. Expenditure incurred in this stage should be recognised as an expense when it is incurred;
 - (b) the application and infrastructure development stage, the graphic design stage and the content development stage, to the extent that content is developed for purposes other than to advertise and promote an enterprise's own products and services, are similar in nature to the development phase in IAS 38.45 to 52. Expenditure incurred in these stages should be included in the cost of a web site recognised as an intangible asset in accordance with paragraph 8 of this interpretation when the expenditure can be directly attributed, or allocated on a reasonable and consistent basis, to preparing the web site for its intended use. For example, expenditure on purchasing or creating content (other than content that advertises and promotes an enterprise's own products and services) specifically for a web site, or expenditure to enable use of the content (e.g. a fee for acquiring a licence to reproduce) on the web site, should be included in the cost of development when this condition is met. However, in accordance with IAS 38.59, expenditure on an intangible item that was initially recognised as an expense in previous financial statements should not be recognised as part of the cost of an intangible asset at a later date (e.g. when the costs of a copyright have been fully amortised, and the content is subsequently provided on a web site);
 - (c) expenditure incurred in the content development stage, to the extent that content is developed to advertise and promote an enterprise's own products and services (e.g. digital photographs of products), should be recognised as an expense when incurred in accordance with IAS 38.57(c). For example, when accounting for expenditure on professional services for taking digital photographs of an enterprise's own products and for enhancing their display, expenditure should be recognised as an expense as the professional services are received during the process, not when the digital photographs are displayed on the web site;
 - (d) the operating stage begins once development of a web site is complete. Expenditure incurred in this stage should be recognised as an expense when it is incurred unless it meets the criteria in IAS 38.60.
10. A web site that is recognised as an intangible asset under paragraph 8 of this interpretation should be measured after initial recognition by applying the requirements of IAS 38.63 to 78. The best estimate of a web site's useful life should be short.

Date of consensus: May 2001.

Effective date: This interpretation becomes effective on 25 March 2002. The effects of adopting this interpretation should be accounted for using the transition requirements of IAS 38.118 to 121. Therefore, when a web site does not meet the criteria for recognition as an intangible asset, but was previously recognised as an asset, the item should be derecognised at the date when this interpretation becomes effective. When a web site exists and the expenditure to develop it meets the criteria for recognition as an intangible asset, but was not previously recognised as an asset, the intangible asset should not be recognised at the date when this interpretation becomes effective. When a web site exists and the expenditure to develop it meets the criteria for recognition as an intangible asset, was previously recognised as an asset and initially measured at cost, the amount initially recognised is deemed to have been properly determined.

STANDING INTERPRETATIONS COMMITTEE INTERPRETATION SIC-33**Consolidation and equity method — potential voting rights and allocation of ownership interests**

Paragraph 11 of IAS 1 (revised 1997), presentation of financial statements, requires that financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable standard and each applicable interpretation issued by the Standing Interpretations Committee. SIC interpretations are not expected to apply to immaterial items.

Reference: IAS 27, consolidated financial statements and accounting for investments in subsidiaries (reformatted 1994), IAS 28, accounting for investments in associates (revised 2000), IAS 39, financial instruments: recognition and measurement (revised 2000).

Issue

1. An enterprise may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the enterprise voting power or reduce another party's voting power over the financial and operating policies of another enterprise (potential voting rights).
2. The issues are:
 - (a) when assessing whether an enterprise controls or significantly influences another enterprise according to IAS 27 and IAS 28 respectively,
 - (i) whether the existence and effect of potential voting rights should be considered, in addition to the factors described in IAS 27.12 and IAS 28.4 and 5; and
 - (ii) if so, whether any other facts and circumstances related to potential voting rights should be assessed;
 - (b) whether the proportion allocated to the parent and minority interests in preparing consolidated financial statements under IAS 27, and the proportion allocated to an investor that accounts for its investment in an associate using the equity method under IAS 28, should be determined based on present ownership interests or ownership interests that would be held if the potential voting rights were exercised or converted; and
 - (c) the appropriate accounting treatment for potential voting rights until they are exercised or expire.

Consensus

3. The existence and effect of potential voting rights that are presently (i.e. currently) exercisable or presently convertible should be considered, in addition to the factors described in IAS 27.12 and IAS 28.4 and 5, when assessing whether an enterprise controls (as defined in IAS 27.6) or significantly influences (as defined in IAS 28.3) another enterprise. All potential voting rights should be considered, including potential voting rights held by other enterprises. Potential voting rights are not presently exercisable or presently convertible when, for example, they cannot be exercised or converted until a future date or upon the occurrence of a future event.
4. All facts and circumstances that affect potential voting rights considered in accordance with paragraph 3 of this interpretation should be examined, except the intention of management and the financial capability to exercise or convert. Other facts that should be considered include the terms of exercise of the potential voting rights and possible linked transactions. (Appendix A provides illustrations of application of this interpretation.)
5. The proportion allocated to the parent and minority interests in preparing consolidated financial statements under IAS 27, and the proportion allocated to an investor that accounts for its investment using the equity method under IAS 28, should be determined based solely on present ownership interests. An enterprise may, in substance, have a present ownership interest when for example, it sells and simultaneously agrees to repurchase, but does not lose control of, access to economic benefits associated with an ownership interest. In this circumstance, the proportion allocated should be determined taking into account the eventual exercise of potential voting rights and other derivatives that, in substance, presently give access to the economic benefits associated with an ownership interest. (Appendix B provides illustrations of application of this interpretation.)

SIC-33

6. When applying the consolidation and the equity method of accounting, instruments containing potential voting rights should be accounted for as part of the investment in a subsidiary and the investment in an associate respectively only when the proportion of ownership interests is allocated by taking into account the eventual exercise of those potential voting rights in accordance with paragraph 5 of this interpretation. In all other circumstances, instruments containing potential voting rights should be accounted for in accordance with IAS 39.

Date of consensus: August 2001.

Effective date: This interpretation becomes effective for annual financial periods beginning on or after 1 January 2002. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.
