

Manual of accounting

IFRS 2013 – Volume 1

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International standards and interpretations

International standards

IFRS 1	First-time adoption of International Financial Reporting Standards
IFRS 2	Share-based payment
IFRS 3	Business combinations
IFRS 4	Insurance contracts
IFRS 5	Non-current assets held for sale and discontinued operations
IFRS 6	Exploration for and evaluation of mineral resources
IFRS 7	Financial instruments: Disclosures
IFRS 8	Operating segments
IFRS 9	Financial instruments
IFRS 10	Consolidated financial statements
IFRS 11	Joint arrangements
IFRS 12	Disclosure of interests in other entities
IFRS 13	Fair value measurement
IAS 1	Presentation of financial statements
IAS 2	Inventories
IAS 7	Cash flow statements
IAS 8	Accounting policies, changes in accounting estimates and errors
IAS 10	Events after the balance sheet date
IAS 11	Construction contracts
IAS 12	Income taxes
IAS 16	Property, plant and equipment
IAS 17	Leases
IAS 18	Revenue
IAS 19	Employee benefits
IAS 20	Accounting for government grants and disclosure of government assistance
IAS 21	The effects of changes in foreign exchange rates
IAS 23	Borrowing costs
IAS 24	Related-party disclosures
IAS 26	Accounting and reporting by retirement benefit plans
IAS 27	Consolidated and separate financial statements
IAS 28	Investment in associates
IAS 29	Financial reporting in hyper-inflationary economies
IAS 31	Interests in joint ventures
IAS 32	Financial instruments: presentation
IAS 33	Earnings per share
IAS 34	Interim financial reporting
IAS 36	Impairment of assets
IAS 37	Provisions, contingent liabilities and contingent assets
IAS 38	Intangible assets
IAS 39	Financial instruments: Recognition and measurement
IAS 40	Investment property
IAS 41	Agriculture

should generally use the going concern basis, recognise assets and liabilities only when they meet the definitions in the Framework, and so on.

3.5 The Framework sets out two fundamental qualitative characteristics of financial statements that are needed if the financial information is to be useful: namely, relevance and faithful representation. Materiality is a sub-principle of relevance. Characteristics of faithful representation are for information to be complete, neutral and free from error. Furthermore the usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable. [Framework paras QC4 to QC32]. These fundamental and enhancing qualitative characteristics are considered further in chapter 1.

3.6 One of the Framework's purposes is to assist the IASB in developing and reviewing existing international financial reporting standards (IFRSs). It is also intended to assist the IASB in promoting harmonisation of regulations by providing a basis for reducing the number of alternative accounting treatments permitted by international financial reporting standards.

3.7 Using the Framework as a basis, the IASB has adopted a large number of standards and interpretations that lay down either single accounting policies to be applied in complying with the standard or, in a few cases, alternative accounting policies that may be followed. As a result, selection of accounting policies by entities is largely pre-determined by existing standards.

Accounting policies contained in standards and interpretations

3.8 IAS 8 requires that where a standard or interpretation applies to a transaction, other event or condition, an entity should determine the accounting policy or policies to be applied to that item by reference to the requirements of that standard or interpretation. [IAS 8 para 7]. The standard notes that IFRSs are sometimes accompanied by guidance to assist entities in applying their requirements. All guidance will state whether it is an integral part of the IFRS and, therefore, forms parts of the requirements of the standard or interpretation. Guidance that is not integral is merely useful when applying the IFRS. [IAS 8 para 9]. In addition, standards include paragraphs in bold type and plain type. The paragraphs have equal authority, although the paragraphs in bold type indicate the main principles. [Preface to IFRSs para 14].

3.9 IAS 8 notes that IFRS sets out accounting policies that the IASB considers will result in financial statements that contain relevant and reliable information about the transactions, other events and conditions to which they apply. [IAS 8 para 8]. (The Framework has replaced 'reliable' with 'faithful representation', but IAS 8 has not yet been amended to reflect this.) Of the enhancing qualitative characteristics in the Framework (see para 3.5 above), understandability and comparability should follow automatically because standards (and the accounting policies they prescribe) ought to be understandable and, by definition, should promote comparability.

3.10 Where an accounting standard permits an entity to adopt one of two alternative accounting treatments, it is important that the entity clearly indicates the alternative that has been adopted (and which should be applied consistently, unless a standard permits otherwise). Examples of standards that have alternatives include IAS 16 and IAS 19. IAS 16 permits an entity to adopt either an historical cost policy or a revaluation policy for selected classes of assets (see chapter 16). IAS 19 permits a choice of policy for the presentation of pension cost where the profit or loss expense can be one total or can be split between operating and financing (see further chapter 11).

Materiality

3.11 IAS 8 notes that policies need not be applied where the effect of applying them is immaterial. [IAS 8 para 8]. This complements the statement in IAS 1 that disclosures required by IFRS need not be made if the information is immaterial. [IAS 1 para 31].

3.12 IAS 8 defines 'material' as it applies to omissions and misstatements (see para 3.66 onwards). The definition is "*Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor*". [IAS 8 para 5]. The definition is consistent with the definition of materiality in the Framework (as a sub-principle of relevance) and so may also be applied to the application of accounting policies, particularly as non-application of a policy will often result in an omission or misstatement in any case.

3.13 In applying the definition of materiality, an entity should consider the characteristics of the users of the financial statements. The Framework states that financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. [Framework para QC32]. Consideration of materiality, therefore, needs to take account of how the economic decisions of such users would reasonably be expected to be influenced. [IAS 8 para 6]. In our view, reasonable knowledge of accounting would include the knowledge that financial statements are normally prepared on a going concern and accruals basis and a basic knowledge of the structure, content and purpose of the statement of comprehensive income, balance sheet, cash flow statement and statement of changes in equity.

3.14 Also, in relation to materiality, the standard notes that it is inappropriate to make or leave uncorrected, immaterial departures from IFRS to achieve a particular presentation of an entity's financial position, financial performance or cash flows. [IAS 8 para 8]. This statement implies that a departure that achieves a particular presentation can be immaterial. However, if that particular presentation is different from the presentation that would be achieved through compliance with the standard, it may be likely to influence the economic decisions

of a user and hence be material. Examples of such departures would include situations where a small uncorrected error could trigger a breach of borrowing covenants or an employee share option award. Accordingly, even departures that appear to be relatively immaterial because of their size should be considered carefully.

3.15 We consider that a standard should be applied unless it is judged that the effects are clearly immaterial. This judgement will require an appropriate analysis, which should take into consideration classification, recognition, measurement and disclosure issues. Arguments that it is impracticable to apply a standard, or that amounts cannot be determined, are rarely reasons for considering the effect to be immaterial, because in the absence of quantification it is generally not possible to judge materiality.

Policies not contained in standards and interpretations

3.16 Where there is no standard or interpretation that specifically applies to a transaction, other event or condition, companies should use their judgement to develop and apply an accounting policy that is both relevant and reliable to the users. Reliability means that the financial statements should:

- Faithfully represent the financial position, financial performance and cash flows.
- Reflect the economic substance of transactions, other events and conditions, and not merely the legal form.
- Be neutral, that is, free from bias.
- Be prudent.
- Be complete in all material respects.

[IAS 8 para 10].

3.17 In the absence of a standard or interpretation, management will usually seek out other guidance to assist them in exercising their judgement to develop and apply an accounting policy. IAS 8 recognises and requires this. It states that management should refer to the following sources and consider their applicability in the order in which they are set out below:

- Requirements in international financial reporting standards and interpretations that deal with similar and related issues.
- The definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.

[IAS 8 para 11].

3.18 The IASB is continually reviewing its existing standards and developing new guidance on issues as they arise, either through specific projects or through IFRS IC interpretations. Specific guidance on new issues is, therefore, sometimes

not available from existing standards or is awaiting a consensus from IFRS IC. Nevertheless, principles and guidance from existing standards can often be useful in determining the appropriate accounting treatment on new issues where the features of a new type of transaction are similar to those covered by an existing standard. In addition, proposals in exposure drafts and guidance in new standards that are not yet effective may also be helpful when considering the accounting for transactions not fully addressed by existing standards. However, care should be taken when considering using proposals in exposure drafts or guidance in new standards for which early adoption is not permitted.

3.19 The IFRS IC published an agenda decision in March 2011 that considered the question of whether it could be appropriate to apply only certain aspects of an IFRS being analogised to, or whether the entire IFRS being analogised to would need to be applied. The IFRS IC observed that when management develops an accounting policy through analogy to an IFRS dealing with similar and related matters, it needs to use its judgement in applying all aspects of the IFRS that are applicable to the particular issue.

3.20 In addition, the standard suggests, but does not require, that management consider the most recent pronouncements by other standard-setters that use a similar conceptual framework as that set out in the IASB's Framework for developing accounting standards, other accounting literature and accepted industry practices, to the extent that they do not conflict with the IASB's standards and interpretations and the IASB's Framework. [IAS 8 para 12].

3.21 Sometimes, where IFRS does not give adequate guidance, entities look to other GAAPs. Specific industry guidance exists under US GAAP, for example, in the motion picture and television industries, which is sometimes referred to by entities in developing their accounting policies under IFRS. Entities may also be more inclined to refer to US GAAP where they have a US listing or significant US shareholders. It should be noted, however, that the application of a US GAAP treatment is appropriate only where that treatment is consistent with the principles underlying IFRS. Care should be taken when applying rules contained in US GAAP or any other GAAP, as they carry a risk of divergence from the principles of IFRS.

Consistency

3.22 Entities should apply their accounting policies consistently, unless a standard permits otherwise (see para 3.23). Generally, if a standard permits or requires different accounting policies to be applied to different categories of items, an entity should select an appropriate policy for each category and apply those policies consistently within each of the categories. [IAS 8 para 13]. For example, IAS 16 permits a policy of revaluation to be adopted for a class of property, plant and equipment, whilst at the same time another class may be measured at historical cost. The principle of consistency requires that, where an entity adopts different policies for different classes of property, plant and equipment, the policy

adopted for each class should be applied consistently to all assets included in that class and from one accounting period to the next.

3.23 In some circumstances, accounting standards may permit entities to apply different accounting policies for similar items. An example is where an entity acquires less than 100% of a business. Under IFRS 3, an entity has a choice, on a transaction-by-transaction basis, regarding how it measures the non-controlling interest. See further chapter 25.

Issues for groups

3.24 Questions may arise as to whether IFRS makes it necessary for consistent accounting policies to be adopted in consolidated financial statements as compared to the individual financial statements of the parent or subsidiaries reporting under IFRS.

3.25 For consolidated financial statements, IAS 27 (or IFRS 10) requires uniform accounting policies to be used for like transactions and other events in similar circumstances. Where any members of the group have adopted different accounting policies in their individual financial statements, appropriate consolidation adjustments should be made to achieve uniformity. [IAS 27 paras 24, 25; IFRS 10 paras 19, B87]. See further chapter 24. A similar requirement to use uniform accounting policies applies for equity-accounted investments. [IAS 28 para 26; IAS 28R para 35].

3.26 However, IFRS does not require the accounting policies of individual financial statements of the parent and its subsidiaries to be the same as those applied in the group's consolidated financial statements. For each entity that reports individually under IFRS, IAS 8 requires management to go through the same accounting policy selection process as for the consolidated financial statements and each entity should select accounting policies that enable its financial statements to give a fair presentation. The factors that the entity's management would take into account in determining the accounting policies for the group's consolidated financial statements would generally also apply to the individual entities. Accordingly, in most cases it would be reasonable to expect that the same accounting policies would be selected for the group, the parent and the subsidiaries reporting under IFRS.

3.27 There may be special reasons for adopting different policies across a group. The particular circumstances and cost-benefit considerations may vary significantly between different reporting entities and their users. As an example, comparability of accounting policies across a group of companies might be highly desirable and useful to the shareholders and potential investors of a listed company. Additionally, if a group also reports under US GAAP, management may wish to minimise the differences between its consolidated IFRS figures and its US GAAP figures. Whereas, comparability might be less of an issue for the users of the individual entities' financial statements, so other factors such as the effect of different accounting policies on subsidiaries' distributable profits, the level of non-

controlling interest or regulatory considerations may weigh more heavily in the selection of their accounting policies.

3.28 Deciding to adopt consistent or different policies in the individual financial statements of the parent or its subsidiaries may involve the judgements of different boards of directors. Where different policies are adopted, an entity should be able to justify this with sound business or commercial reasons.

Changes in accounting policies

3.29 A change in accounting policy should be made only if:

- the change is required by a standard or an interpretation; or
- if the change will result in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

[IAS 8 para 14].

3.29.1 A voluntary change in accounting policies does not involve a free choice for management. The new policy has to be justified in line with the second bullet point above. In addition, some regulators might require independent confirmation that the new policy is preferable to the old one, where the change does not result from a new or amended accounting standard.

3.30 In accordance with the principle of consistency (see para 3.22), an entity should apply the same accounting policy from one period to the next, unless a change in policy meets one of the two conditions specified above. This is because users of the financial statements need to be able to compare the financial statements of an entity over time in order to appreciate trends in its financial position, financial performance and cash flows. [IAS 8 para 15].

3.31 Changes in accounting policies may be categorised according to the three basic processes applied in the preparation of financial statements, namely, (i) recognition, (ii) measurement bases and (iii) presentation.

3.32 Changes in recognition policies would include, for instance:

- Changing revenue recognition regarding the sale of goods and services.
- Changing from recognising actuarial gains and losses on defined benefit pension plans under the 'corridor approach' (spreading in income statement, as previously permitted by IAS 19) to recognising in full as they arise in the statement of comprehensive income. See further chapter 11.

3.33 Changes in policies related to measurement bases would include for example a change from measuring a class of property, plant and equipment at depreciated historical cost to a policy of regular revaluation (note that this is dealt

with prospectively as a revaluation, rather than retrospectively – see para 3.44 below).

3.34 A change in the classification of an item within the balance sheet, income statement or cash flow statement often represents a change in accounting policy related to presentation, except where driven by a change in circumstances (discussed further below).

3.35 IAS 8 notes that the introduction of an accounting policy to account for transactions or events that are different in substance from those previously occurring (that is, where circumstances have changed), is not a change of accounting policy. Similarly, adopting an accounting policy for events or transactions that did not occur previously or that were immaterial in the prior year is not a change of accounting policy and would be applied prospectively. [IAS 8 para 16]. For example, when there is a change in an entity's functional currency, IAS 21 requires the entity to account for this prospectively by translating all items into the new functional currency using the exchange rate at the date of the change (see further chapter 7). A change in functional currency is not a change in accounting policy as it arises as a result of a change to the entity's underlying transactions, events and conditions. [IAS 21 paras 35 to 37].

3.36 Another situation involving a change in circumstances occurs where there is a change in use of an existing asset. This is illustrated in the following example.

Example – Change in use of an existing asset

Entity A owns an office building that it has previously used for its own administrative purposes. Accordingly, the building has been classified as property, plant and equipment and carried at depreciated historical cost. During the current year, management moved the workforce to a new building and leased the old building to a third party. Accordingly, the old building was reclassified as investment property and carried at fair value.

The adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions is not a change in accounting policy. [IAS 8 para 16]. The change represents a change in use of the property and so no restatement of the comparative amounts should be made. [IAS 40 para 61]. The different accounting treatment applied to the same property in the current and prior years is appropriate, because the building was used for different purposes in the two years.

However, it should be noted that where a change in accounting policy is made to revalue the property under IAS 16, without a change in use, specific rules in IAS 8 apply – see paragraph 3.44 below.

3.37 Changes in accounting policy are made on the initial application of a standard or interpretation or may be made on some other voluntary basis. The requirements of IAS 8 differ between these two circumstances and are considered below.

Applying changes in accounting policies

General rules

3.38 A change in accounting policy that is made on the initial application (including early adoption) of an IFRS or interpretation should be accounted for in accordance with the specific transitional provisions of that standard or interpretation, if any. In the absence of any specific transitional provisions, the change should be accounted for in the same way as other voluntary changes in accounting policy described in paragraph 3.39 below. Early adoption of a new standard or interpretation is not classed as a voluntary change and so any specific transitional provisions in that new standard or interpretation should be applied. [IAS 8 paras 19, 20].

3.39 Specific transitional provisions are often included in new or revised IFRSs to allow prospective, rather than retrospective, application of the standard. This is sometimes because it would be impracticable to obtain the information necessary to restate comparatives. It may also be unduly onerous to apply a new accounting treatment on some past transactions (for example, business combinations).

3.40 On occasions, if there is no relevant IFRS, an entity may adopt the provisions of the most recent accounting standard or pronouncement issued by another standard-setter (although any transitional provisions in that standard or pronouncement cannot be used under IFRS). If an entity has used an accounting standard or pronouncement issued by another standard-setter and the standard or pronouncement is subsequently amended, the entity should determine whether the financial information prepared in accordance with the amended pronouncement provides reliable and more relevant information. If that is the case and the entity decides to follow the amended pronouncement, the change is accounted for under IAS 8 as a voluntary change in accounting policy. [IAS 8 para 21].

3.41 Voluntary changes of accounting policy and the adoption of new accounting standards or interpretations where there are no specific transitional rules, including changes in presentation, should be applied retrospectively, except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the change (see from para 3.98 below). All comparative amounts should be adjusted to show the results and financial position of prior periods as if the new accounting policy had always applied. [IAS 8 paras 22, 23]. 'Retrospective application' is defined in IAS 8 as "applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied". [IAS 8 para 5]. The adjustment to all periods prior to those presented should be reported as an adjustment to the opening balance of each affected component of equity (for example, retained earnings) for the earliest period presented. In addition, when an entity applies its changes in accounting policy retrospectively, IAS 1 requires the presentation of an additional balance sheet as at the start of the preceding period (see further paras 3.110, 3.110.1 and 3.112).

- (a) cash or other assets of the entity for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity, or
- (b) equity instruments (including shares or share options) of the entity or another group entity,

provided the specified vesting conditions, if any, are met.”

[IFRS 2 App A].

12.9 Therefore, the requirements of IFRS 2 apply to any transaction in which an entity receives goods or services in exchange for a transfer of its own equity instruments, even if that transfer is made by an existing shareholder rather than by the entity itself. Only when a transfer is clearly for a purpose other than payment for goods or services would it be outside IFRS 2's scope. Furthermore as mentioned above, IFRS 2 will apply where goods or services are obtained by an entity in exchange for equity instruments of its parent or another member of the group. [IFRS 2 para 3A]. Group situations are considered further from paragraph 12.169.

12.10 The standard applies to all share-based payment transactions whether or not the entity can identify specifically some or all of the goods or services received, including:

- **Equity-settled share-based payment transactions** – Share-based payment transactions in which the entity (a) receives goods or services as consideration for its own equity instruments (including shares or share options), or (b) receives goods or services but has no obligation to settle the transaction with the supplier. Such transactions include employee share option and share incentive plans.
- **Cash-settled share-based payment transactions** – Transactions in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity. Typical examples include ‘phantom’ options plans, share appreciation rights and certain long-term incentive awards.
- Transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier of those goods or services with a *choice* of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments.

[IFRS 2 para 2].

12.11 There is no exemption from IFRS 2's scope for employee share purchase plans or similar broad-based employee share plans. In drafting IFRS 2, the IASB did consider including an exemption for plans similar to employee share purchase plans (such as save as you earn (“SAYE”) plans in the UK and employee share

ownership plans (“ESOPs”) in the US) and other broad-based employee share plans. However, they concluded that the accounting for such plans should be no different from other employee share plans. The IASB also rejected the suggestion that plans should be exempted if the discount available to employees is small so that its impact is likely to be immaterial.

[The next paragraph is 12.18.]

12.18 Associates and joint ventures are more complicated. For example, in situations where employees of a joint venture are granted the right to equity instruments over one or both joint venturer's equity instruments, such a transaction in the joint venture would be outside IFRS 2's scope. This is because the joint venture is not part of a group as defined by IAS 27 (superseded by IFRS 10). Although the shareholders of the joint venture are transferring equity instruments in exchange for employee services to the joint venture, the fact that the equity instruments are not those of the joint venture or another entity in the same group as the joint venture means the awards are not in the scope of IFRS 2 in the financial statements of the joint venture. [IFRS 2 para 3A]. The position for associates is the same. Note that investors would be within IFRS 2's scope for their own financial statements as they are indeed issuing their own equity in return for services (see further para 12.61).

12.19 In the situation described in the previous paragraph, the associate or joint venture entity would need to apply the hierarchy within IAS 8 to determine the appropriate accounting treatment, and apply the principles of paragraph 11 of IAS 8. In such a situation, the entity is likely to determine that either IFRS 2 or IAS 19 (refer to chapter 11) is the most appropriate standard. This would be a policy choice that the entity would make under IAS 8, and would have to be applied consistently. It is our view that the most appropriate treatment is to apply the principles of IFRS 2 to employee benefits that are settled in equity (our view is explained further in example 4, para 12.22 below). See from paragraph 12.169 for details of how to apply IFRS 2 in this situation.

12.20 There are few exclusions from IFRS 2's scope, namely:

- Business combinations in the acquirer's financial statements to which IFRS 3 applies, notwithstanding the fact that such a transaction may be equity-settled. However, equity instruments granted to employees of the acquiree in their capacity as employees (for example, to encourage them to remain in the employment of the acquiree after the acquisition) do fall within the scope of IFRS 2. [IFRS 2 para 5]. Similarly, the cancellation, replacement or modification of existing share-based payment arrangements as result of a business combination should be accounted for in accordance with IFRS 2. See from paragraph 12.25 for further discussion of business combinations.
- Contributions of a business on formation of a joint venture and combinations of businesses or entities under common control. This is illustrated from paragraph 12.25.

- Contracts for the purchase of goods, such as commodities, to which IAS 32 and IAS 39 apply, because these are to satisfy the reporting entity's own expected purchase or usage requirements. [IFRS 2 para 6]. This is illustrated in example 1 of paragraph 12.22 below.

Transactions within the scope of IFRS 2

12.21 Further examples of transactions within IFRS 2's scope are set out below.

Example 1 – Purchase of non-financial item expected to be used by the entity

Entity A enters into a contract to purchase silver for use in its jewellery manufacturing business, whereby it is required to pay cash to the supplier in an amount equal to the value of 1,000 shares of entity A at the date the silver is delivered. This meets the definition of a cash-settled share-based payment transaction (entity A has acquired goods in exchange for a payment the amount of which will be based on the value of its shares).

IAS 32 and IAS 39 apply to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase sale or usage requirements. [IAS 32 para 8; IAS 39 para 5]. Regardless of whether the contract may be settled net, as it was entered into for the purpose of taking delivery of the silver for use in entity A's business and entity A has a history of doing this, it does not fall within the scope of IASs 32 and 39. Hence, it does fall within the scope of IFRS 2 as a cash-settled share-based payment transaction.

Example 2 – Definition of goods or services

Entity B is developing a new product and purchased a patent from entity C. The parties agreed a purchase price of 1,000 of entity B's shares. These will be issued to entity C within 60 days of finalising the legal documentation that transfers the patent from entity C to entity B.

This is an equity-settled share-based payment. IFRS 2 is applicable to a share-based payment for a patent. The goods to which IFRS 2 applies include inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets.

Example 3 – Business combination and continued employee service

Entity D acquires 90% of the share capital of entity E. As part of the acquisition, entity D grants entity E's employees share options that vest after 2 years if the employees remain in service.

In this transaction, equity instruments are granted to employees of the acquiree in their capacity as employees and so fall within IFRS 2's scope. [IFRS 2 para 5].

Example 4 – Award of parent entity shares by a shareholder

An individual with a 40% shareholding in entity F awards 2% of his shareholding in entity F to a director of entity F's subsidiary, entity G.

The award is within IFRS 2's scope. A shareholder of entity F has transferred equity instruments of entity F (entity G's parent) to a party that has supplied services to the entity. [IFRS 2 para 3A]. The award will be reflected in both entity G's financial statements and entity F's consolidated financial statements.

Example 5 – Services paid for by issuing warrants

During the year, entity K's bank provided services to entity K; entity K agreed to issue warrants to the bank as consideration for this service. The warrants have a fixed subscription price and entity K will settle the warrants in equity – that is, if the bank chooses to exercise the warrants, it will receive one entity K share for each warrant held in return for paying the fixed subscription price.

Entity K has received services as consideration for issuing equity instruments of entity K. This is an equity settled share-based payment, which should be accounted for in accordance with IFRS 2.

Example 6 – Formation of a joint venture

Entities X and Y have formed an incorporated joint venture, entity Z. On formation, in exchange for their equity interests in Z, entity X contributed property, plant and equipment and entity Y contributed intangible assets that do not constitute a business.

The asset contributions by venturers X and Y upon entity Z's formation are equity-settled share-based payment transactions from Z's perspective and fall within IFRS 2's scope. The scope exclusion of paragraph 5 of IFRS 2 does not apply, as the formation of a joint venture does not meet the definition of a business combination and X and Y contributed assets not businesses. See further example 2 in paragraph 12.25 below, where the formation of a joint venture is determined to fall within the scope exclusion because two separate entities are being contributed to the formation of the joint venture. See further chapter 28.

Transactions outside the scope of IFRS 2

12.22 The following are examples of transactions that are outside the scope of IFRS 2.

Example 1 – Commodity contracts

Entity H enters into a contract to purchase 100 tonnes of cocoa beans. The purchase price will be settled in cash at an amount equal to the value of 1,000 of entity H's shares. However, the entity may settle the contract at any time by paying an amount equal to the current market value of 1,000 of its shares less the market value of 100 tonnes of cocoa beans. The entity has entered into the contract as part of its hedging strategy and has no intention of taking physical delivery of the cocoa beans.

As in example 1 in paragraph 12.21 above, the transaction meets the definition of a cash-settled share-based payment transaction (entity H has acquired goods in exchange for a payment of which the amount will be based on the value of its shares). However, unlike example 1 in paragraph 12.21, the contract may be settled net and has not been entered into in order to satisfy entity H's expected purchase, sale or usage requirements. Accordingly, the transaction is outside IFRS 2's scope and is instead dealt with in accordance with the requirements of IASs 32 and 39. See further chapter 6.

Example 2 – Cash payments dependent on earnings multiple

A non-quoted entity issued share appreciation rights (SARs) to its employees. The SARs entitle the employees to a payment equal to any increase in the entity's share price between the grant date and the vesting date. The arrangement's terms and conditions define the share price used to calculate payments to employees as five times EBITDA divided by the number of shares in issue.

IFRS 2 is unlikely to be applicable to this transaction because a fixed multiple of EBITDA is not likely to reflect the fair value of the entity's share price. If it does not, management should apply IAS 19 to this deferred compensation arrangement.

Example 3 – Plan investing in other entity shares

Entity I is implementing an unusual share option incentive plan. Entity I will lend cash to an employee share trust, which will purchase shares in a number of publicly listed companies (but not shares in entity I or any other entities within the same group as entity I). These companies may be suppliers, customers or competitors. Entity I's employees are granted options over 'units' held by the employee share trust, which are shares in listed companies. The units are an amalgam of the shares held by the trust. The units do not entitle the employees to any equity interest in the trust itself. The options are granted at market value at the date of the grant and held over a three year period. When employees exercise their option over the units, they are paid the difference in cash between the market price of the units at the date of the grant (the exercise price) and the market value at the date of exercise. To fund the cash payment the trust sells the shares relating to the exercised units. It then repays the relevant portion of the loan from entity I and also pays the gain to employees (this assumes the price of the underlying investments has increased in value following the grant).

This transaction is outside IFRS 2's scope as the rights are over shares of companies other than the reporting entity, or companies within the entity's group

Accounting for the changes in value of the assets in the trust will depend on how the assets are classified. If they fall into the definition of a plan asset under paragraph 7 of IAS 19 then they should be accounted for in line with IAS 19. Otherwise, the assets will be included in the consolidated accounts and should be treated as available-for-sale financial assets in line with IAS 39. The related liability will be within IAS 19's scope. See further chapter 11.

Accounting for employee share trusts is considered in detail from paragraph 12.241.

Example 4 – Share options in a joint venture

Entity J is a 50:50 joint venture between entities K and L. Entity K grants senior employees of entity J options over its own shares without making any charge to entity J. Entity L does not provide any contribution to the joint venture to compensate entity K. Entity K applies the equity method to investments in joint ventures in its consolidated financial statements and the cost method in its separate financial statements.

Entity J's financial statements

IFRS 2 includes within its scope transfers of equity instruments of an entity's parent or of an entity in the same group in return for goods or services. [IFRS 2 para 3A]. However, entity K is a joint venture investor and is not entity J's parent, nor is it in the same group (defined in IAS 27 or superseded by IFRS 10 as being 'a parent and all its subsidiaries') as entity J. Therefore, on initial consideration, from entity J's perspective, the award in entity J of share options in entity K is not within IFRS 2's scope.

The arrangement also falls outside IAS 19's scope. IAS 19 applies to all employee benefits, but defines those as "all forms of consideration given by an entity in exchange for service rendered by employees". Because no consideration is given by entity J, this does not meet the definition of an employee benefit.

However, IAS 8 requires entities to apply a hierarchy when determining their accounting policies. Where there is no IFRS governing a transaction, IAS 8 requires management to look first to any IFRS standard or interpretation dealing with similar or related issues. Paragraph 10 of IAS 8 states that in the absence of a standard or interpretation that specifically applies to a transaction, "management shall use its judgment in developing and applying an accounting policy". Furthermore, paragraph 11 of the standard clarifies that in making such a judgement, management should consider "the requirements and guidance in standards and interpretations dealing with similar and related issues". While it is not a formal requirement, it is our view that the most appropriate treatment will be for entity J to apply the principles of IFRS 2 to this equity-settled share-based payment. This is further supported by the treatment where a parent entity grants options over its own shares to those of its subsidiary. In this case, while entity K does not meet the definition of a parent company, in the absence of any other guidance, this is an acceptable approach. (See further para 12.169.)

The disclosure requirements of IAS 24 should be applied by entity J if any of the employees are key management personnel. See further chapter 29.

Note that if compensation was, however, given by entity J for the share-based payment, perhaps in the form of a recharge payment required by entity K, then the transaction would be within IAS 19's scope.

Entity K's financial statements

Entity K has an equity-settled share-based payment arrangement and should measure the goods and services received in accordance with IFRS 2 as appropriate. Thus, in its separate financial statements, entity K would capitalise the IFRS 2 grant date fair value into its cost of the investment in the joint venture and consider whether there were any impairment indicators.

Entity K's consolidated financial statements should apply the principles of IAS 31 (or superseded by IAS 28 (revised)). To the extent that entity J has accounted for the share-based payment, 50% of this would be recorded by entity K when the equity method is applied. In addition, since entity L did not provide an equivalent contribution into the joint venture, entity K would record an additional cost resulting in its consolidated financial statements recording 100% of the share-based payment charge.

Entity L's financial statements

Other than the fact that entity L will need to account for its joint venture in entity J, there will be no impact on entity L's separate financial statements. To the extent that entity J has accounted for the share-based payment the proportional share (that is, 50%) of the charge that is recorded by entity L on consolidation would be eliminated against the gain recorded on application of paragraph 48 of IAS 31 (or paragraph 28 of IAS 28 (revised)), hence, there is no impact on consolidation.

12.23 In some cases, the number of equity instruments to which a counterparty is entitled varies. For example, share appreciation rights may be settled in shares such that the number of shares issued to employees varies according to the appreciation of the employer's share price over a period of time. If the requirements of IAS 32 were applied to transactions such as these, an obligation to issue equity instruments would be classified as a liability (a variable number of shares issued for a fixed amount – see further chapter 6). This would have implications for the basis of measurement of the transaction as discussed later in this chapter. For example, equity-settled transactions involving employees are measured at the date on which awards are granted and are not re-measured, whereas liabilities in respect of cash-settled transactions are re-measured at each balance sheet date. However, employees will ultimately receive equity instruments of the reporting entity; the award is therefore accounted for as an equity-settled share-based payment. The IASB concluded that different considerations applied in developing IFRS 2 and the standard inserts an amendment to IAS 32 that exempts from its scope any transactions to which IFRS 2 applies (except as discussed in para 12.20 above). [IAS 32 para 4(f)].

12.24 The following examples consider some practical issues when determining whether a transaction is within the scope of IFRS 2.

Example 1 – Bonus with past history of cash settlement

An entity agrees to pay its employees a bonus. The entity has a choice of settlement, either cash or shares with a value equivalent to the value of cash payment. The entity has a past practice of settling in cash and is considering whether the transaction should be accounted for under IFRS 2.

It could be argued that by applying the principles of IAS 32, shares issued for a fixed amount would be accounted for as a liability and, hence, this type of award should be in the scope of IAS 19 and not IFRS 2. However, as the entity has a *choice* that allows it to settle the award using equity instruments or cash (and, therefore, could issue equity instruments), the transaction is a share-based payment with a settlement choice (see further from para 12.162). [IFRS 2 para 2c].

Example 2 – Variable number of shares for goods

Entity A signed a contract with a construction entity to acquire a new building for C1m with ownership transferring to entity A when the construction work is complete. The purchase price will be settled by entity A issuing a variable number of its own shares with a total market value of C1m.

As the purchase price is being settled in shares, the transaction is within IFRS 2's scope and is excluded from the scope of IAS 32. See further example 11 of paragraph 12.114.

Example 3 – Non-recourse loan enabling counterparty to purchase shares

An entity lends C100 to an employee to purchase the entity's shares from the market. The loan is interest free and only has recourse to the shares. Dividends paid on the shares must be used to reduce the loan. The employee must pay back the balance of the loan, or return the shares at the earlier of three years or resignation.

In November 2005, the IFRS IC confirmed that this transaction would fall within the scope of IFRS 2. The IFRS IC stated that the loan is considered to be part of a share-based payment transaction, which in substance is an option with a three year exercise window where the exercise price is reduced by any dividends. The employee is not exposed to any downside risk in the movement of the share price over the three year period as he/she can repay the loan or surrender the shares. The 'loan' is, therefore, recognised as a debit in equity. The option would be exercised on the date the loan is repaid. In this example the option would vest immediately as the employee could leave on day one, repay the loan and be fully entitled to the shares. Vesting conditions are considered in detail from paragraph 12.77. See example 2 of paragraph 12.114 for a worked example of the accounting treatment.

Example 4 – Full recourse loan enabling counterparty to purchase shares

The facts are the same as example 3 above, except the entity has recourse to personal assets of the employee as well as the shares. This means that if the employee fails to repay the loan, the entity has the ability to take possession of the employee's personal assets such as their car, house, etc.

The employee is unconditionally bound to repay the loan. The entity should record a receivable for the loan balance. Since the terms of the loan with the company are such that a preferential interest rate has been given to employees, a fair value adjustment to the loan balance should be recognised (under IAS 39) as an employee remuneration expense over an appropriate service period in accordance with IAS 19. This is because the fair value of the loan has been reduced through a preferential rate and a benefit has been provided to the employee.

Full recourse loans with employees are rare in practice. Before an entity determines that they have granted a full recourse loan to employees, the following factors should be considered to determine if the loan is, in substance, non-recourse:

- The employer has legal recourse to the employee's other assets but does not intend to seek repayment beyond the shares issued.