and generally representative of fair value. However, the definition of a closing price may represent different things on different exchanges for different types of financial instruments. For example, a closing price may range from the last transaction price for the day to a price derived from a complicated calculation or process. If an asset or a liability is subject to a bid-ask spread (see 2.4.250), then an entity needs to assess the nature of the closing price. [*IFRS 13.B34*]

2.4.280.130 In some cases, the quoted price in an active market may not represent fair value at the measurement date – e.g. if a significant event takes place after the close of a market but before the measurement date, such as the announcement of a business combination. In that case, an entity chooses an accounting policy, to be applied consistently, for identifying those events that may affect fair value measurements. This exception is limited to situations in which the significant event takes place after the close of the market but before the measurement date. It does not apply to situations in which the event takes place after the measurement date. [*IFRS 13.79(b)*]

EXAMPLE 8 – ADJUSTMENT TO LEVEL 1 INPUTS – AFTERMARKET TRANSACTIONS

2.4.280.140 Company P invests in shares of Company T that are listed on the London Stock Exchange (LSE). On the reporting date, P obtains the closing price of the shares from the LSE. After the closing time of the LSE but still on the reporting date, T makes a public announcement that affects the fair value of its shares; this is evidenced by prices for a small number of aftermarket transactions in depository receipts on the shares of T that are traded on the New York Stock Exchange.

2.4.280.150 In this example, P uses the aftermarket prices to make appropriate adjustments to the closing price from the LSE, in order to measure the fair value of the shares at the measurement date. Because the adjustment is derived from observed market prices, the resulting fair value measurement is a Level 2 measurement.

2.4.280.160 In our experience, pricing data from aftermarket trades or trades for identical or similar assets or liabilities in another market may be useful to determine the existence of a significant event that affects the fair value measurement of an asset or liability. Pricing data may also be used to determine the amount of the adjustment to be made to the last quoted price sourced from the entity's principal (or most advantageous) market.

2.4.280.170 If an entity uses pricing data from aftermarket trades or trades for identical or similar assets or liabilities in another market to determine the amount of the adjustment, then it should support that adjustment through an analysis of how the pricing data or their underlying factors affect the fair value of the asset or liability.

2.4.280.180 This analysis may be based on quantitative and qualitative factors to assess whether the pricing data is relevant to the fair value measurement of the asset or liability being measured. For example, if an entity uses a statistical method in its analysis, then to the extent that the analysis supports a correlation coefficient that is other than 1:1, that factor may need to be applied to pricing data from aftermarket trades or trades for identical or similar assets or liabilities in another market

to develop the adjustment to be applied to the last quoted price in the entity's principal (or most advantageous) market.

2.4.280.190 This analysis may also include a comparison between the pricing data from aftermarket trades or trades for identical or similar assets or liabilities in another market and the subsequent price in the entity's principal (or most advantageous) market. To the extent that a difference is found through this analysis, an adjustment to the last quoted price from the entity's principal (or most advantageous) market may need to reflect this difference.

EXAMPLE 9 – ADJUSTMENT TO LEVEL 1 INPUTS – OIL FUTURES CONTRACTS

2.4.280.200 Company G holds oil futures contracts at the New York Mercantile Exchange (NYMEX). On the reporting date, G obtains the closing price of the oil futures from NYMEX. On the reporting date, but subsequent to the closing time of NYMEX, there is a public announcement that affects oil prices and related financial instruments. This is evidenced by prices of oil forward contracts transacted in the over-the-counter market on the reporting date.

2.4.280.210 G needs to evaluate the futures prices with forward contracts to factor how correlated the futures and forward markets are. If this analysis supports a correlation, and the correlation coefficient is other than 1:1, then that factor may need to be applied to the aftermarket forward prices to determine the appropriate adjustments to the price quoted on NYMEX.

2.4.280.220 Because of the adjustment to the price obtained from the principal market, the resulting fair value measurement would generally be expected to be a Level 2 measurement. However, if the unobservable inputs are significant, then a Level 3 designation would be appropriate.

2.4.280.230 An entity may measure the fair value of a liability or its own equity instruments using the quoted price of an identical instrument traded as an asset. However, there may be specific differences between the item being measured and the asset. This may happen, for example, if the identical instrument traded as an asset includes a credit enhancement that is excluded from the liability's unit of account (see 2.4.80 and 380). [*IFRS 13.39(b), 79(c)*]

2.4.280.240 Any adjustment to a quoted price in an active market will result in the fair value measurement being categorised into a lower level of the fair value hierarchy. Although a price that is adjusted based on one of the limited circumstances in 2.4.280.70 is no longer a Level 1 measurement, in our view an entity should not make other adjustments to that measurement (e.g. for market or other risks), except if the criteria to make one of the other adjustments to Level 1 prices in 2.4.280.70 are met. We believe that the circumstances that allow an entity to exceptionally adjust Level 1 inputs only allow for adjustments related to those circumstances. [*IFRS 13.79*]

2.4.280.250 Positions in a single asset or liability (including a group of identical assets or liabilities) that are traded in an active market are measured at fair value within Level 1 as the product of the quoted price for the individual asset or liability and the quantity held. This is the case even if:

the percentage attributable to the NCI. If the derecognition criteria have not been met in respect of the remaining shares to be sold, then NCI are measured without taking the agreement to sell into account.

EXAMPLE 36 – AGREEMENT TO SELL OWNERSHIP INTERESTS IN THE FUTURE

2.5.830.20 Company P owns 100% of Company S. P enters into an agreement with Company Q to sell 40% of its shares in S at the reporting date and an additional 20% at the end of each year for the next three years. The price of the shares to be sold will be based on a fixed price determined at the agreement date.

2.5.830.30 If P retains control of S, then P considers the derecognition criteria in IAS 39 to determine the percentage attributable to the NCI. If the derecognition criteria have not been met in respect of the remaining shares to be sold, then the NCI would be measured based on a 40% interest at the reporting date.

2.5.840 Contingent consideration in seller's financial statements

2.5.840.10 A receivable relating to contingent consideration in the seller's financial statements is accounted for under IAS 39 if the receivable meets the definition of a financial instrument. [*IAS 32.AG8*]

2.5.840.20 Contingent consideration receivable is accounted for as a contingent asset in accordance with IAS 37 if it is a non-financial asset – e.g. property (see 3.12.876). [*IAS 37.31–35*]

2.5.850 DISCLOSURES

2.5.850.10 IFRS 12 requires disclosure of the significant judgements and assumptions that an entity has made in determining the nature of its interest in another entity or arrangement. It also contains extensive disclosure requirements for subsidiaries and unconsolidated structured entities. These disclosures are illustrated in KPMG's *Guide to financial statements* series. The discussion in this section focuses only on areas of uncertainty in practice. [*IFRS 12.7*]

2.5.850.20 The objective of IFRS 12 is to require disclosure that helps users of financial statements to evaluate:

- the nature of, and risks associated with, an entity's interests in other entities; and
- the effects of those interests on the entity's financial position, financial performance and cash flows. [*IFRS 12.1*]

2.5.850.30 In this context, 'interests in other entities' are contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. These interests may, for example, take the form of equity or debt instruments, but the definition is broad and interests can also comprise other forms of involvement, such as the provision of funding, liquidity support, credit enhancement and/or guarantees. However, an interest in another entity does not exist solely as a result of a typical customer-supplier relationship. [*IFRS 12.A*]

2.5.850.40 Interests in another entity are the basis for many of the disclosures in IFRS 12. Understanding the purpose and design of the other entity (see 2.5.50) may assist in identifying such interests.

The entity considers the risks that the other entity was designed to create, and the risks that the other entity was designed to pass on to the reporting entity and other parties, see 2.5.230. [*IFRS 12.B7*]

2.5.850.50 In addition, IFRS 12 requires an entity to provide disclosure about its relationships with unconsolidated structured entities that it sponsors even if it does not have an interest in them at the reporting date (see 2.5.910). [*IFRS 12.27–28*]

2.5.855 FORTHCOMING REQUIREMENTS

2.5.855.10 IFRS 14 permits first-time adopters of IFRS to continue accounting for regulatory deferral account balances in accordance with their previous accounting policies. If an entity elects to apply IFRS 14, then under IFRS 12 it is required to provide additional disclosures relating to the regulatory deferral account balances, or net movements therein, in its first IFRS financial statements and in subsequent periods (see 6.2A.120). [*IFRS 14.B25–B28*]

2.5.860 Aggregation*

2.5.860.10 The disclosures may be aggregated for interests in similar entities, with the method of aggregation being disclosed. A quantitative and qualitative analysis, taking into account the different risk and return characteristics of each entity, is made in order to determine the aggregation level. IFRS 12 gives the following examples of aggregation levels: by nature of activities, by industry or by geography. [*IFRS 12.4, B2–B6*]

2.5.860.20 As a minimum, information is given separately for interests in each of subsidiaries, joint ventures, joint operations, associates and unconsolidated structured entities. [*IFRS 12.B4*]

2.5.870 Structured entities

2.5.870.10 A 'structured entity' is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate only to administrative tasks and the relevant activities are directed by means of contractual arrangements. [*IFRS 12.A*]

2.5.870.20 Whether an investee is a structured entity is a key factor in determining the extent of disclosures required under IFRS 12.

- Paragraphs 10(b)(ii) and 14–17 of IFRS 12 require an entity to disclose the nature of and changes in the risks associated with its interests in *consolidated* structured entities (see 2.5.900).
- Paragraphs 24–31 of IFRS 12, supported by B25–B26, require an entity to disclose information about its interests in *unconsolidated* structured entities (see 2.5.910).

2.5.870.30 The discussion in 2.5.880–890 is focused on determining the population of entities that are in the scope of these disclosure requirements.

2.5.880 *Characteristics*

2.5.880.10 To supplement the definition, IFRS 12 indicates that a structured entity often (i.e. not always) has some or all of the following characteristics:

- restricted activities;

2.6.10 SCOPE#

2.6.10.10 IFRS 3 does not apply to the formation of a joint venture; the acquisition of an asset (group of assets) that does not meet the definition of a business; or a combination of entities or businesses under common control. [*IFRS 3.2*]

2.6.10.20 Transactions that give rise to the formation of a joint venture are outside the scope of IFRS 3 (see 3.6.350). However, IFRS 3 is applied to a business combination entered into by a joint venture after its formation. [*IFRS 3.2(a)*]

2.6.10.30 If an entity acquires an asset or a group of assets (including any liabilities assumed) that does not constitute a business, then the transaction is outside the scope of IFRS 3 because it cannot meet the definition of a business combination. Such transactions are accounted for as asset acquisitions in which the cost of acquisition is allocated between the individual identifiable assets and liabilities in the group based on their relative fair values at the date of acquisition. For a discussion of the acquisition of tax losses other than in a business combination, see 3.13.1210. [*IFRS 3.2(b)*]

2.6.10.40 A business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the combination, and that control is not transitory, is outside the scope of IFRS 3. For a detailed discussion of common control transactions, see chapter 5.13. [*IFRS 3.2(c)*]

2.6.15 FORTHCOMING REQUIREMENTS

2.6.15.10 *Annual Improvements to IFRSs 2011–2013 Cycle – Amendment to IFRS 3* clarifies that the scope exclusion for joint ventures (see 2.6.10.20) applies to all joint arrangements – i.e. joint ventures *and* joint operations – and only in the financial statements of the joint arrangement itself. [*IFRS 3.2(a)*]

2.6.20 IDENTIFYING A BUSINESS COMBINATION

2.6.20.10 A 'business combination' is a transaction or other event in which an acquirer obtains control of one or more businesses. An acquirer may obtain control in a number of ways including, for example, by transferring cash or other assets, incurring liabilities, issuing equity instruments or without transferring consideration. The structure of a transaction or event does not affect the determination of whether it is a business combination; whether an acquirer obtains control of one or more businesses is the determining factor. [*IFRS 3.B5*]

2.6.20.20 A 'business' is an integrated set of activities and assets that is capable of being conducted and managed to provide a return to investors (or other owners, members or participants) by way of dividends, lower costs or other economic benefits. A business generally consists of inputs, processes applied to those inputs and the ability to create outputs. [*IFRS 3.A, B7*]

2.6.20.30 For a transaction or event to be a business combination, the activities and assets over which the acquirer has obtained control is required to constitute a business. [*IFRS 3.3*]

2.6.30 Inputs, processes and outputs

2.6.30.10 For an integrated set of activities and assets to be considered a business, the set needs to contain both inputs and processes. Outputs are not required to qualify as a business as long as there is the ability to create outputs. If the acquired set includes only inputs, then it is accounted for as an asset acquisition rather than as a business combination (see 2.6.10.30). The key terms are defined as follows.

	Description	Examples
Inputs	Economic resources that create (or have the ability to create) outputs when one or more processes are applied to them.	Non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights, and employees.
Processes	Systems, standards, protocols, conventions or rules that create (or have the ability to create) outputs when they are applied to inputs.	Strategic management processes, operational processes and resource management processes. These processes are typically documented, but an organised workforce with the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. Accounting, billing, payroll and other administrative systems are not typically processes used to create outputs.
Outputs	The result of inputs and processes applied to those inputs that provide, or have the ability to provide, a return in the form of economic benefits.	Goods and services.

2.6.30.20 The acquisition of all of the inputs and processes used by the seller in operating a business is not necessary for the activities and assets acquired to meet the definition of a business. What is important is that a market participant (see 2.4.90 in the context of fair value) would be capable of producing outputs by integrating what was acquired either with its own inputs and processes or with inputs and processes that it could obtain. Therefore, it is not relevant whether the seller operated the set as a business or whether the acquirer intends to operate it as a business. [*IFRS 3.B8, B11*]

2.6.30.30 In our view, a significant characteristic of a business is that the underlying activities and assets are integrated. A group of assets without connecting activities is unlikely to represent a business.

2.6.30.40 If the acquiree has employees and the related employment contracts are transferred to the acquirer, then this may indicate that a business has been acquired. However, in our view a group

any impairment. Otherwise, a non-monetary asset purchased during the reporting period is indexed up to reflect the change in the price index from that at the date of acquisition to that at the reporting date. However, if an asset or liability has been revalued, then it is adjusted only from the date of the valuation. If the item is stated at the fair value at the reporting date (e.g. investment property), then it is not restated. [*IAS 29.12–16*]

2.10.90.50 Deferred taxes are calculated in accordance with IAS 12 after the restatement of non-monetary items (see chapter 3.13).

2.10.100 Step 3: Restate statement of profit or loss and OCI

2.10.100.10 A hyperinflationary statement of profit or loss and OCI includes the gain or loss from holding monetary assets or liabilities and income and expenses during the period. The gain or loss from holding monetary assets or liabilities is included in profit or loss. Any income earned or expense incurred during the period will need to be indexed up from the date initially recorded to reflect the purchasing power at the reporting date. For practical reasons, average indexation rates may be acceptable if the overall result is not materially different from the result that would be obtained by indexing individual items of income and expense based on the date at which the transaction took place. In our experience, a single annual average often may not be appropriate due to the speed and exponential way in which the index rises in a hyperinflationary economy. [*IAS 29.26*]

2.10.100.20 The gain or loss from holding monetary assets or liabilities is an economic concept. Suppose that an entity held 1,000 of cash (and 1,000 of share capital), and had no other assets, liabilities or transactions throughout a year when the CPI index has moved from 100 to 150. The entity has made an economic loss, and current purchasing power accounting forces this to appear in the financial statements. The economic loss exists as follows: the entity would need 1,500 of cash at the reporting date to be in the same purchasing power position as having 1,000 of cash at the beginning of the reporting period, and a loss of 500 has actually occurred.

2.10.110 Worked example of IAS 29 restatements

EXAMPLE 2 – RESTATEMENTS TO REFLECT PURCHASING POWER AT REPORTING DATE

2.10.110.10 Company H was incorporated in December 2012 with a cash capital contribution of 100, and started its operations in 2013.

2.10.110.20 The following facts are also relevant for this example.

- In December 2013, H bought a piece of land for 600, and entered into a five-year loan. The land is measured at cost.
- In October 2014, H bought inventories, which remained unsold on 31 December 2014.
- H's functional currency has been considered hyperinflationary since 2012.

2.10.110.30 The following table shows a general price index of the economy in which H operates, on specified dates.

Price index at:	
31 December 2012	100
31 December 2013	150
31 October 2014	180
31 December 2014	200
Average price index during 2014	175

Statements of financial position before IAS 29 restatement

	31 Dec 2014 HISTORICAL PURCHASING POWER	31 Dec 2013 HISTORICAL PURCHASING POWER
Share capital (contributed on 31 December 2012)	100	100
Retained earnings	1,050	800
Total equity	1,150	900

	31 Dec 2014 HISTORICAL PURCHASING POWER	31 Dec 2013 HISTORICAL PURCHASING POWER
Land (acquired on 31 December 2013)	600	600
Investment securities held for trading	250	150
Inventories (acquired on 31 October 2014)	100	-
Trade receivables	500	200
Cash	100	350
Loan payable	(400)	(400)
Net assets	1,150	900

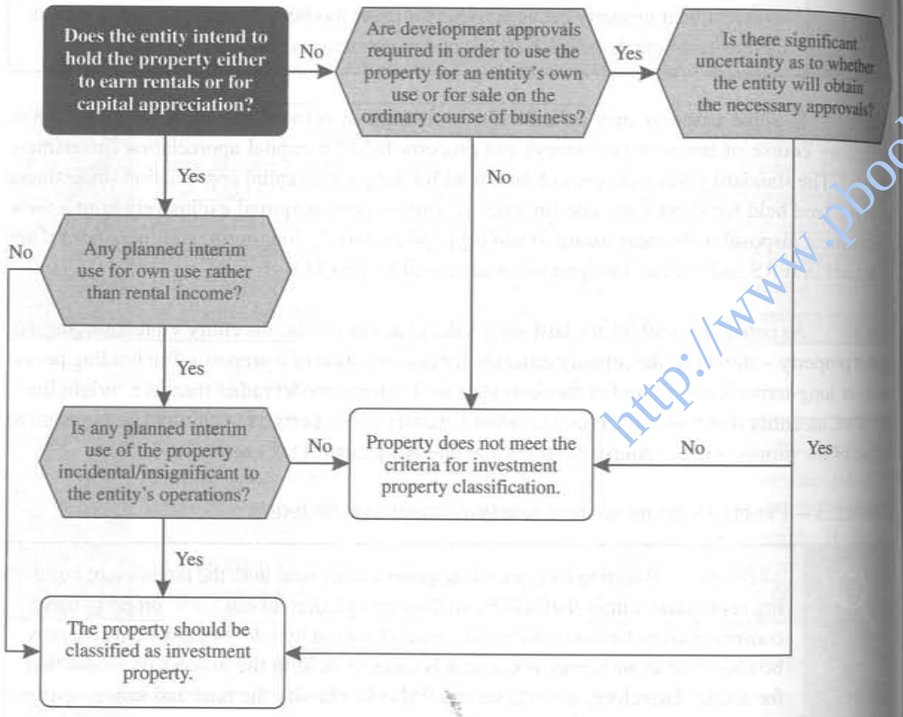
Statement of profit or loss and OCI before IAS 29 restatement

	2014
Revenue	1,150
Gain on change in fair value of investment securities	100
Interest on loan payable	(100)
Other expenses	(900)
	250

Example 4A – Undetermined future use of property

3.4.60.130 Company E pays 400 to acquire an interest in a piece of empty land. E has not yet decided what it will do with the land, but it acquired the interest because it considered the asking price to be a bargain. E classifies the land as investment property, because the land is held for an undetermined future use; it is transferred to inventory if and when development for sale commences (see 3.4.200).

3.4.60.140 In some cases, the determination of whether land has an undetermined future use requires judgement and is dependent on the specific facts and circumstances. In our view, if there is significant uncertainty about whether an entity is able to develop land for its own use or for sale in the ordinary course of business as intended by management, then the land is deemed to be held for an undetermined future use and is classified as investment property. We believe that factors to take into account to determine if property is held for an undetermined future use include, but are not limited to, the following.



3.4.60.150 The determination of the degree of uncertainty surrounding the ability to use the property as intended and the significance of any planned interim use will require judgement based on the specific facts and circumstances.

Example 4B – Undetermined future use – Inventory or owner occupied

3.4.60.160 Modifying Example 4A, Company E evaluates two development options: construction of a hotel that it will own and operate, and construction of a residential complex with a view to selling individual units in the complex in the ordinary course of business. E's ultimate decision will depend on the outcome of detailed project development proposals and market analysis. This process is expected to take two years to complete and management has already begun the process of developing the alternative proposals and has obtained the necessary permits to construct either development option.

3.4.60.170 We believe that the criteria for investment property classification are not met because management intends to hold the developed property either for its own use or for sale in the ordinary course of business. Because the developed property will not be held to earn rental income or for capital appreciation, and there is no uncertainty about whether the property can be developed for own use or sale in the ordinary course of business, investment property classification is not appropriate (see 3.4.10.20).

Example 4C – Undetermined future use – Obtaining permits

3.4.60.180 Modifying Example 4B, Company E purchased the land for the purpose of developing a residential complex with the intention to sell once construction is completed. In the jurisdiction in which the land is located, E is required to obtain various substantive permits from the local government authority before any construction activities may commence. Receipt of such permits is dependent on approval of the planned use of the property and completion of environmental impact studies. E estimates that the process of obtaining the permits will take at least five years to complete. E cannot be certain that the necessary permits will be granted and will continue to review the best use of the property in order to maximise its investment in the land.

3.4.60.190 In this case, E cannot begin physical development work immediately because the land is not zoned for the intended use. Therefore, E should consider all relevant facts and circumstances in order to assess the appropriate classification. These include:

- the degree of uncertainty about whether the permits will be obtained – e.g. probability that all required permits will be obtained;
- the length of time to obtain the permits;
- existence of regulatory restrictions on the use of the property; and
- the other options that E may pursue to realise the value of the land – e.g. using the land as owner-occupied property.

3.4.60.195 In this example, considering all facts and circumstances, if there is significant uncertainty about whether E will be able to use the land as planned for sale, then we believe that E should classify the land as investment property.

EXAMPLE 7B – SHARE OPTIONS ISSUED TO ASSOCIATE EMPLOYEES – ENTRIES ON EXERCISE

3.5.400.50 Continuing Example 7A, assume that at the end of the vesting period all options vest and are exercised. Each option has an exercise price of 3. Company C records the following entry.

In C's financial statements	DEBIT	CREDIT
Cash	3,000	
Shareholders' equity (parent)		3,000
To recognise exercise of options at associate level (1,000 x 3)		

3.5.400.60 The issue of new share options results in a dilution of Company B's interest in C by 10% (30% - (600 / (2,000 + 1,000)); B maintains significant influence over C (see 3.5.570.20). Immediately before the shares are issued, C has net assets totalling 11,000. B records the following entry.

In B's financial statements	DEBIT	CREDIT
Loss on dilution (profit or loss)	200	
Investment in associate		200
To recognise dilution of investment in associate at investor level		

Calculation of loss on dilution	
B's share of net assets before exercise (11,000 x 30%)	3,300
B's share of net assets after exercise ((11,000 + 3,000) x 20%)	(2,800)
Cumulative adjustment required	500
Less: adjustment previously recognised for share-based payment expense (60 x 5 years)	(300)
Loss on dilution	200

Note

(1)	Net assets lost (11,000 x 10%)	(1,100)
	Share of proceeds on exercise of options (3,000 x 20%)	600
	Cumulative adjustment required	500

3.5.410 *Warrants*

3.5.410.10 In our view, when an equity-accounted investee issues a warrant (option) to a third party for cash, no entry should be recognised by the investor because both the debit entry to recognise the

investor's share of the proceeds and the offsetting credit entry are made to the investor's interest in the investee (see 3.5.400.10). If the warrant is unexercised, then we believe that an investor should choose an accounting policy, to be applied consistently, of either recognising an entry in profit or loss or recognising it in equity. Example 8 illustrates both approaches.

3.5.410.15 Under the first approach, the investor recognises a gain in profit or loss when the warrant expires, on the basis that there has been an increase in the investor's net assets in the investee. This approach views the event as an increase in the net assets in the investee, as though the investee bought back the warrant for no consideration. This also results in similar accounting to that applied if an additional interest in the investee were received for no consideration, with the resulting excess being recognised in profit or loss.

3.5.410.17 Under the second approach, the investor recognises an adjustment in equity when the warrant expires. This is on the basis that the investor's share of the expired warrant should also be recognised because it represents additional net assets of the investee that are to the benefit of its shareholders that have been realised with no additional ownership interests being issued. Under this approach, recognising a gain in profit or loss would not be appropriate because no equivalent gain is recognised by the investee.

EXAMPLE 8 – WARRANTS ISSUED BY ASSOCIATE

3.5.410.20 Investor Q holds 40% of Associate A. A issues a warrant to a third party for a cash premium of 100, exercisable in two years. After two years, the third party does not exercise the warrant and it expires. A's net assets are 1,000 – unchanged during the period except for the cash received on issuing the warrant. On issue, A records the receipt of cash and the warrant issued. Q does not record an entry.

In A's financial statements	DEBIT	CREDIT
Cash	100	
Equity		100
To record receipt of cash on issue of warrant		

3.5.410.30 Under the first approach (see 3.5.410.15), the investor recognises a gain in profit or loss when the warrant expires. Accordingly, Q records the following entry.

In Q's financial statements	DEBIT	CREDIT
Investment in associate (100 x 40%)	40	
Gain on lapse of warrants (profit or loss)		40
To record expiration of warrant		

that Z will buy 10,000 beds from Y. Therefore, in our view Z should record the beds at the expected cost of 90 per unit and recognise a receivable for the anticipated rebate.

3.8.160.40 If it is not probable that the required criteria to earn the rebate will be met, or the amount of the rebate cannot be estimated reliably, then the purchase cost is measured at the gross amount payable, until such time as it becomes probable that a rebate will be received and the amount of that rebate can be estimated reliably.

3.8.160.50 If the discount or rebate is recognised subsequent to when the item is sold, then in our view the proportion of the discount attributable to the sold items should be recognised as an adjustment to cost of sales at the same time as the discount or rebate is recognised.

EXAMPLE 4B – VOLUME DISCOUNT – NOT PROBABLE TO BE EARNED

3.8.160.60 If, in the fact pattern described in Example 4A, it had not initially been probable that Z would buy the required 10,000 beds, then Z would have recorded each of the beds bought at a gross unit cost of 100 each.

3.8.160.65 Assume that after nine months, Z has bought 9,000 beds and concludes that it is now probable that it will meet the minimum purchase of 10,000 beds and will receive the 10% rebate. At that date, 3,000 beds are still on hand. The other 6,000 beds have been sold.

3.8.160.67 In our view, Z should reduce the cost of each of the remaining beds by 10 – i.e. 30,000 (3,000 x 10) of the rebate should be allocated to reduce the cost of inventory. The remaining 60,000 should be recognised in profit or loss immediately as a reduction of cost of sales.

3.8.160.70 In our view, incentives for early payment (settlement discounts) should be treated as a reduction in the purchase price. Generally, when such discounts are not taken, the cost of inventory is the higher amount payable before discount, provided that payment is not deferred beyond normal credit terms (see 3.8.150). This approach is consistent with the assumption that there is no financing element when payment is within normal credit terms.

3.8.170 Costs of production or conversion

3.8.170.10 The costs of production or conversion include all direct costs such as labour, material and direct overheads and an allocation of fixed and variable production overheads. These include the depreciation and maintenance of factory buildings and equipment; amortisation of intangible assets such as software used in the production process; and the cost of factory management and administration. Labour costs include taxes and employee benefit costs associated with labour that is involved directly in the production process. The costs do not need to be external or incremental. [*IAS 2.12*]

3.8.170.20 The following are recognised as an expense and are not allocated to the cost of inventory in the statement of financial position:

- impairment losses, including goodwill impairment losses;
- abnormal amounts of wasted material, labour or other production costs (see 3.8.190); and
- general administration costs unrelated to the production of inventory – e.g. the costs of operating a finance department.

3.8.180 *Decommissioning and restoration costs*

3.8.180.10 Decommissioning and restoration costs incurred as a consequence of the production of inventory in a particular period are part of the cost of that inventory (see 3.2.70.30). Accordingly, the effect of any changes to an existing obligation for decommissioning and restoration costs related to items that have been sold are recognised in profit or loss. [*IAS 16.16(c), 18, IFRIC 1.4*]

3.8.190 *Allocation of fixed production overheads*

3.8.190.10 The allocation of fixed production overheads is based on the normal capacity of production facilities. Any inefficiency is recognised in profit or loss, classified as other expenses or, if an entity classifies expenses based on function, allocated to the appropriate function. [*IAS 2.13*]

3.8.190.20 In determining what constitutes normal capacity, an entity considers the following factors:

- the nature of the business, economic factors, the status of product life cycles and the reliability of forecasts;
- the maximum capacity and expected utilisation of production facilities, including planned maintenance and shut-downs; and
- the expected levels of activity to be achieved on average over a number of periods, adjusted for unusual fluctuations or circumstances.

EXAMPLE 5 – ALLOCATING FIXED PRODUCTION OVERHEADS

3.8.190.30 Assume that under normal operating conditions Company J expects to produce 100 coffee machines a year. Budgeted and actual fixed production overheads for 2014 are 800. Therefore, the fixed overhead cost per machine based on normal production levels is 8.

3.8.190.40 During 2014, due to problems with the production machinery and decreased demand, J produces only 80 coffee machines. The production overheads are allocated based on the normal production levels of 100 (i.e. 8 per unit). Therefore, of the total production overheads of 800, only 640 (80 x 8) is allocated to inventory. The other 160 is recognised as an expense as it is incurred.

3.8.190.50 However, if during 2014 in response to increased demand for coffee machines J increased production shifts and produced 130 machines, then the amount allocated to the inventory would be limited to the actual expenditure. Therefore, if the total production overheads remain constant at 800, then a cost of 6.15 (800 / 130) is allocated to each machine.

Asset	Carrying amount post-impairment	Recoverable amount based on fair value less costs of disposal	Reversal of impairment at individual asset level	Revised carrying amount
Goodwill	-	-	-	-
Land	100	130	30	130
Building	41	35	-	41
Machinery	109	25	-	109
Total	250	190	30	280
			CGU recoverable amount	210
			Impairment loss	(70)

3.10.425.80 In applying Step 1, X reverses 30 (130 - 100) of the impairment loss previously recognised against land. The carrying amount of the CGU after Step 1 is 70 greater than its recoverable amount of 210. This impairment loss of 70 is allocated to the assets within the CGU in Step 2.

3.10.425.90 In Step 2, X compares the revised carrying amount of the CGU, including any increase as a result of impairment reversals in Step 1, to its recoverable amount. In Step 2, X follows the same process as in 3.10.425.30 and 50.

Asset	Post-Step 1 carrying amount	Pro rata impairment allocation[1]	Carrying amount after pro rata impairment allocation	Recoverable amount based on fair value less costs of disposal	Impairment loss allocated	Allocate remaining impairment loss[2]	Carrying amount post-impairment
Goodwill	-	-	-		-	-	-
Land	130	-	130	130	-	-	130
Building	41	(19)	22	35	(6)	-	35
Machinery	109	(51)	58	25	(51)	(13)	45
Total	280	(70)	210	190	(57)	(13)	210
CGU recoverable amount	210						
Impairment loss	(70)						
Impairment reversal	30						
Net impairment loss	(40)						

Notes
(1) Pro rata allocation of the 70 (280 - 210) impairment loss to the building and machinery only. For example, the building is impaired by 19 – (41 / 150) x 70
(2) Excess impairment loss of 13 related to the building – i.e. 19 less cap of 6

PRESENTATION

3.10.430

3.10.430.10 IAS 36 does not specify the line item in profit or loss in which an impairment loss should be recognised; however, it does require disclosure of the line items in which impairment losses are included. [*IAS 36.126*]

3.10.430.20 If an entity classifies expenses based on their function (see 4.1.30), then any loss is allocated to the appropriate function. In our view, in the rare case that an impairment loss cannot be allocated to a function, then it should be included in other expenses as a separate line item if it is significant – e.g. impairment of goodwill (see 4.1.30.10) – with additional information given in a note.

3.10.430.30 In our view, an impairment loss that is recognised in published interim financial statements should be presented in the same line item in the annual financial statements. We believe that this applies even if the asset is subsequently sold and the gain or loss on disposal is included in a line item different from impairment losses in the annual financial statements.

SPECIFIC APPLICATION ISSUES

3.10.440

Allocating goodwill to CGUs

3.10.450

3.10.450.10 The guidance in 3.10.160 discusses the impairment testing of goodwill. However, before the actual impairment testing, it is necessary to understand how goodwill is allocated to CGUs or groups of CGUs, and how that allocation may change over time.

Level at which to allocate goodwill

3.10.460

3.10.460.10 Each unit or group of units to which goodwill is allocated:

- should represent the lowest level within the entity for which information about goodwill is available and monitored for internal management purposes; and
- should not be larger than an operating segment, determined in accordance with IFRS 8 before applying the aggregation criteria of IFRS 8 (see 5.2.50). [*IAS 36.80–84*]

3.10.460.20 The allocation test related to operating segments in IFRS 8 applies regardless of whether the entity is required to present segment information (see 5.2.10).

3.10.460.30 Goodwill is allocated to the lowest level at which it is monitored for internal management purposes. This is to avoid the need to develop additional reporting systems to support goodwill impairment testing. However, this does not mean that entities can avoid testing goodwill at a level lower than an operating segment by simply not monitoring goodwill explicitly.

is no corresponding remeasurement of the tax base. On settlement of the forward, the net receipt of 10 is taxed.

3.13.160.90 S's policy may be to transfer the gain on the forward of 10 from OCI to the carrying amount of inventory – i.e. make a basis adjustment (see 7.7.80.40). In this case, the initial carrying amount of the inventory is 90, and a temporary difference of 10 arises on the inventory.

3.13.160.100 Conversely, S's policy may be to transfer the gain of 10 to profit or loss when the inventory affects profit or loss. In this case, the initial carrying amount of the inventory is 100 and no temporary difference arises on the inventory.

3.13.165 FORTHCOMING REQUIREMENTS

3.13.165.10 Under IFRS 9, the accounting policy choice described in 3.13.160.50–100 is not available. If a cash flow hedge of a forecast transaction subsequently results in the recognition of a non-financial item, then IFRS 9 requires an entity to:

- remove the entire related amount accumulated in the cash flow hedge reserve; and
- include it directly in the initial cost or other carrying amount of the item (see 7A.670.50). [*IFRS 9.6.5.11(d)*]

3.13.170 Foreign currencies and hyperinflation

3.13.170.10 Sometimes, temporary differences are created when changes in exchange rates lead to changes in the tax basis rather than the book basis. This situation usually arises when an entity has a functional currency that is different from the currency of the country in which it is domiciled. For example, an entity based in the UK may have some operations in Germany for which sterling is the functional currency (see 2.7.30). As a result, non-monetary property, plant and equipment in Germany is translated from euro into sterling once, using the historical rate at the transaction date. [*IAS 12.41*]

3.13.170.20 If the asset is part of a unit paying tax in Germany, then the tax basis in euro is retranslated from euro to sterling at the exchange rate at the reporting date. Therefore, book value remains at the historical value, whereas the tax base is translated to the current rate at each reporting date. This translation difference may create temporary differences. Deferred tax is recognised for this temporary difference in line with the general principles for recognising income tax assets and liabilities (see 3.13.320 and 330).

3.13.170.30 This applies even when the non-monetary assets are part of a foreign branch that has the same functional currency as its parent. In that case, the special recognition criteria regarding investments in subsidiaries, associates and joint arrangements (see 3.13.260) do not apply. This is because the non-monetary assets are those of the entity itself, not the overall investment. [*IAS 12.41, IE.A.17, IE.B.13*]

3.13.170.40 The foreign currency translation reserve arising from the translation of foreign operations in the consolidated financial statements does not in itself result in deferred tax assets or liabilities. The foreign currency translation reserve is neither an asset nor a liability, and does not give rise to temporary differences. However, exchange differences arising on the translation of the financial statements of foreign

operations might have associated tax effects that affect the financial statements. For example, an entity intends to sell an investment in a subsidiary in the foreseeable future. In this case, it recognises deferred taxes on temporary differences arising from that investment (see 3.13.260.40–50). Suppose that part of these differences arises from translating the financial statements of foreign operations; in this case, the deferred tax effect in respect of these differences will be recognised in OCI (see 3.13.530.10).

3.13.170.50 In some jurisdictions, foreign currency gains and losses are netted for tax purposes, and the net gain (loss) is taxable (deductible) in instalments over several years. In our view, if a single tax base exists under applicable tax law, then it is appropriate to present a net deferred tax liability (asset). [*IAS 12.5*]

3.13.170.60 An entity operating in a hyperinflationary economy will make current purchasing power adjustments to its assets (see chapter 2.10). Although the carrying amount in the financial statements is increased, the tax base remains stated in the historical measuring unit. In such cases, temporary differences arise and are recognised in full. [*IAS 12.IE.A.18*]

3.13.180 Other differences

3.13.180.10 Some differences that arise between IFRS and the corresponding tax treatment may not give rise to a deferred tax liability (asset), because an item that affects the accounting will not be taxable or deductible in the future. Although there is no definition of such items in IFRS, they are often referred to as 'permanent' differences.

EXAMPLE 8 – 'PERMANENT' DIFFERENCES

3.13.180.20 One of Company D's investees has declared a dividend of 100. D has recognised a receivable in its financial statements. In D's jurisdiction, dividends are tax-exempt. In this case, no deferred tax liability is recognised, following either of the following analyses.

- The tax base of the receivable is zero and therefore there is a temporary difference of 100; however, a tax rate of zero will apply when the cash is received. Therefore, no deferred tax liability is recognised.
- The tax base of the receivable is 100 because, in substance, the full amount will be tax-deductible – i.e. the economic benefits are not taxable. Therefore, no deferred tax liability is recognised, because the tax base is equal to the carrying amount of the asset. [*IAS 12.7*]

3.13.190 DETERMINE IF RECOGNITION EXEMPTION APPLIES AND IF RECOGNITION CRITERIA MET

3.13.200 Initial recognition exemption

3.13.210 *General principles*

3.13.210.10 Deferred tax is not recognised for certain temporary differences that arise on the initial recognition of assets and liabilities. The exemption is not conceptual in nature and is one of the more difficult aspects of the standard to apply. The exemption applies to:

- a deferred tax liability (but not a deferred tax asset) that arises from the initial recognition of goodwill (see 3.13.990); and

3.13.760.70 The revaluation is credited to a revaluation reserve in equity (for tax purposes). On distribution of the revaluation reserve, further income tax is payable at a rate of 15% (the normal income tax rate of 40% minus the 25% tax already paid).

3.13.760.80 Company C revalues its property, plant and equipment for tax purposes, but no revaluation is recognised under IFRS. On 31 December 2014, the carrying amount under IFRS equals the tax base before a revaluation of 100. C records the following entries.

	Debit	Credit
Income tax (profit or loss)	25	
Income tax payable		25
To recognise current tax (100 x 25%)		
Deferred tax asset	40	
Income tax (profit or loss)		40
To recognise deferred tax asset (100 x 40%)		

3.13.760.90 No deferred tax liability is recognised for the additional tax to be paid on distribution until the related dividend is recognised (see 3.13.750.10). The recognition of the deferred tax consequences of the tax revaluation, which in Example 42B is in profit or loss, is discussed in 3.13.570.10.

3.13.770 Dividend withholding tax

3.13.770.10 In some tax jurisdictions, a dividend withholding tax is payable on distributions to shareholders. Such taxes are not attributable to the entity paying the dividend; instead, the entity collects and pays them to the tax authorities on behalf of the shareholder. Therefore, such taxes are recognised directly in equity as part of the distribution to shareholders. [*IAS 12.65A*]

Example 43 – Dividend withholding tax

3.13.770.20 Company M declares a dividend of 200, 20% of which is payable to the tax authorities. M records the following entry.

	Debit	Credit
Distribution (equity)	200	
Liability (to shareholders)		160
Liability (to the tax authorities)		40
To recognise distribution of dividend and resulting withholding tax		

3.13.770.30 For a discussion of the accounting for the potential income tax effects of such distributions in the financial statements of a parent, see 3.13.260.

3.13.770.40 In our view, withholding taxes attributable to investment income (e.g. dividends received) should be recognised as part of income tax expense, with the investment income recognised on a gross basis. This is because neither IAS 18 nor IAS 12 provides any mechanism for income tax paid to be offset against the underlying income. [*IAS 12.2*]

3.13.780 Dividend credits

3.13.780.10 In some tax jurisdictions, an entity may 'attach' credits to a dividend payment that are used by the shareholder to offset tax payable on the dividend. These credits provide relief from double taxation, because the profits from which the dividend is paid have already been taxed at the entity level.

Example 44A – Credit attached to dividend payment

3.13.780.20 In Country T, shareholders are taxed on the gross amount of the dividend plus any credit attached. However, they then receive a deduction against tax payable for the amount of the credit; the tax rate is 30%.

3.13.780.30 Company B receives a dividend of 100 from Company C, with an 'attached' dividend credit of 43 (30 / (100% - 30%)).

3.13.780.40 B's tax is calculated as follows.

Dividend received	100
Dividend credit received	43
Taxable income	143
Income tax at 30%	43
Less deduction	(43)
Tax payable	-

3.13.780.50 For accounting purposes, an entity needs to determine how it should present the dividend received in profit or loss – either net or gross of the dividend credit.

3.13.780.60 In our view, net presentation is more appropriate. This is because the dividend credit is simply a mechanism to ensure that certain dividends (or parts thereof) are tax-exempt. We believe that the net presentation reflects that substance.

Example 44B – Credit attached to dividend payment – Gross vs net presentation

3.13.780.70 Continuing Example 44A, the table below illustrates the net and gross presentation of the dividend credit for Company B. As noted in 3.13.780.60, we believe that the net presentation reflects the substance of the transaction.

4.4.600.20 For a discussion of insurance policies issued to the plan by the reporting entity or a related party of the reporting entity, see 4.4.660.

4.4.600.30 Plan assets exclude contributions receivable from the reporting entity and other financial instruments issued by the reporting entity and held by the fund that cannot be transferred to third parties – e.g. non-transferable loans by the fund to the reporting entity (see 4.4.1500). [*IAS 19.8, 114*]

4.4.600.40 In our view, the requirement for financial instruments to be transferable to qualify as plan assets applies to instruments issued by all entities that are part of the group – i.e. parent, intermediate and ultimate parent, and subsidiaries – in both separate and consolidated financial statements.

4.4.600.50 In our view, financial instruments of associates and joint ventures in which group entities have invested qualify for treatment as plan assets if they are transferable and the other criteria for treatment as plan assets are met. If financial instruments issued by associates and joint ventures are not transferable, then we believe that an entity can still treat them as plan assets – in both separate and consolidated financial statements – because they are not part of the group. This is an accounting policy choice that should be applied consistently.

4.4.610 *Replacement assets*

4.4.610.10 In some cases, assets of the fund can be returned to the entity in situations other than when it is for reimbursement of employee benefits paid or when the fund is in surplus (see 4.4.840). In these cases, the entity is typically required to provide replacement assets to the fund. In our view an entity's ability to replace existing plan assets does not preclude classification of the assets as assets, if the current fair value of the replacement assets is required to be equal to or higher than the fair value of the assets replaced and the substitution can be made only if the trustees of the fund agree. We believe that this is similar to the sale of the assets by the fund. However, it is critical in such cases that the entity delivers equivalent or greater current fair value to be considered similar to a sale. This is because any below-market exchange represents a transfer of value to the entity, which would preclude the assets from qualifying as plan assets (see 4.4.560).

4.4.620 Measurement

4.4.620.10 Plan assets are measured at fair value in accordance with IFRS 13, which is the subject of chapter 2.4. For assets measured at fair value that have a bid and ask price, IFRS 13 requires the use of the price within the bid-ask spread that is the most representative of fair value in the circumstances. Under IFRS 13, the use of bid prices for long positions and ask prices for short positions is permitted but not required. For further discussion of the use of inputs based on bid and ask prices in measuring fair value, see 2.4.250. [*IAS 19.57(a)(iii), IFRS 13.70*]

4.4.620.20 The requirement to measure plan assets at fair value overrides the requirements of other standards. Therefore, in our view if the plan has a controlling interest in another entity, then the investment should be measured at fair value and the underlying entity should not be consolidated (see 4.4.1490). Similarly, shares of the plan sponsor (employer) that qualify as plan assets should be measured at fair value and not presented as a deduction from equity, which is normally the treatment of treasury shares (see 7.3.420).

4.4.620.30 Plan assets may include non-financial assets such as property; in our view, they should also be measured at fair value, even if they were transferred to the fund by the entity in settlement of contributions due to the fund and were previously measured at cost by the entity. The measurement of fair value under IFRS 13 reflects any special characteristic of the assets – e.g. their location or age (see 2.4.70). Differences between the carrying amount of the asset derecognised by the entity and the fair value of the contribution made may result in a gain or loss on contribution.

EXAMPLE 12 – PLAN ASSETS – TRANSFER OF NON-FINANCIAL ASSETS TO PLAN

4.4.620.40 Company B contributes property to its plan with a carrying amount of 100 and a fair value of 160 in settlement of contributions due to the fund of 160. The gain of 60 arising on the contribution of the asset could be viewed either as a plan asset remeasurement gain recognised in OCI, or as a gain recognised in profit or loss by B in the period in which the asset is contributed. Because B has transferred the risks and rewards of ownership to the fund and the plan assets are not consolidated by B, in our view B should recognise the gain of 60 in profit or loss in the period in which the asset is contributed.

4.4.620.50 In some cases, the entity may continue to use the asset after the asset has been contributed to the plan – e.g. a leaseback of a contributed office building. In such cases, the entity considers the requirements for the transfer of risks and rewards of ownership under IAS 17, which may affect the assessment of whether a gain should be recognised (see 5.1.470).

4.4.630 Assets that do not qualify as plan assets

4.4.630.10 In our view, investments held by employee benefit plans that do not qualify as plan assets should be accounted for by the entity in the same way as its other financial assets (see chapters 7.5 and 7.6) but also might be classified as a reimbursement right (see 4.4.640). If the investments include shares of the entity itself, then the requirements for treasury shares apply (see 7.3.420).

4.4.640 Reimbursement rights

4.4.640.10 If an entity will be reimbursed for expenditure that is required to settle a defined benefit obligation, but the reimbursement right does not give rise to a plan asset (see 4.4.560), then the reimbursement right is recognised as a separate asset when recovery is virtually certain. For example, an insurance policy that is not a plan asset generally gives rise to a reimbursement right. [*IAS 19.116*]

4.4.640.20 In our view, the reimbursement right needs to be due from a party outside the group (S) (which may include an associate or joint venture (see 4.5.120.60)). Therefore, a right to receive assets from another group entity – e.g. parent, subsidiary – to fund employee benefit obligations is not treated as a reimbursement right in the consolidated financial statements. However, it may be appropriate to recognise a reimbursement right in the separate financial statements of the entity providing that the criteria in paragraph 116 of IAS 19 are met. [*IFRS 4.IG2.Ex1.21*]

4.4.640.30 Reimbursement rights are accounted for in the same way as plan assets – i.e. they are measured at fair value and the changes in fair value of the reimbursement rights are accounted for in

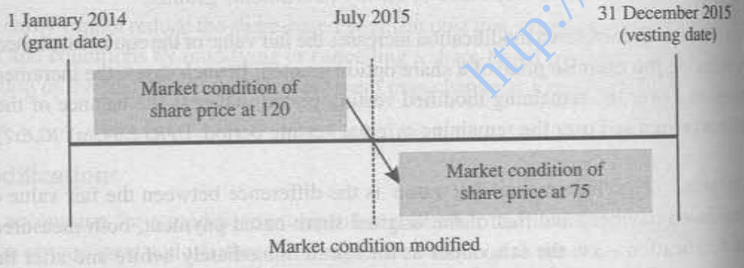
fied such that only the non-market performance target is modified, and all other terms and conditions remain the same, then the incremental fair value is zero (see 4.5.1270.10). This is because the fair value measured on an IFRS 2 basis – i.e. without adjustments for service and non-market performance conditions – is the same before and after the modification. [*IFRS 2.27, B43(a)*]

4.5.1250.20 If an award that contains a market condition is modified by an entity to make the market condition easier to meet, then this is a modification of a vesting condition that is beneficial to employees. The original market condition is taken into account in estimating the fair value of the original grant at the date of modification. If it is unlikely that the original market condition will be met at the date of modification, then the fair value of the original award at the date of modification may be significantly lower than the fair value of the original award as determined at grant date.

Example 15 – Modification of share-based payment that is beneficial

4.5.1250.30 On 1 January 2014, Company D granted 1,000 shares for no consideration to its CEO, subject to a two-year service condition and the share price achieving a target of 120. At grant date, the share price is 100 and the grant-date fair value of the equity instrument granted, including consideration of the possibility of not meeting the share price target, is 80.

4.5.1250.40 In July 2015, the share price decreases to 70 and D now estimates that it is highly unlikely that the share price target will be met. To motivate the CEO, the market condition is reduced to a share price target of 75. The fair value of the equity instrument granted considering the market condition immediately before the modification is 1 and immediately after the modification is 56; the incremental fair value is therefore 55 per share.



4.5.1250.50 D recognises the grant-date fair value of the equity instruments granted of 80,000 (1,000 x 80) over 2014 and 2015 in respect of the original grant. Additionally, D recognises the incremental fair value of 55,000 (1,000 x 55) in 2015, assuming that the CEO fulfils the service requirement. The total compensation cost that will be recognised of 135,000 is greater than the fair value of the modified award of 56,000.

4.5.1260 Increases in number of equity instruments granted

4.5.1260.10 If a modification increases the number of equity instruments granted, then the entity recognises the fair value of the additional equity instruments measured at the date of modification. The additional share-based payment cost is attributed over the period from the date of modification to the end of the vesting period of the additional equity instruments. [*IFRS 2.B43(b)*]

4.5.1270 Beneficial modifications of service and non-market performance conditions

4.5.1270.10 If the modification changes a service condition or non-market performance condition in a manner that is beneficial to an employee – e.g. by reducing the vesting period or by modifying or eliminating a non-market performance condition – then the remaining grant-date fair value is recognised using the revised vesting expectations with true-up to actual outcomes (see 4.5.1280–1290). [*IFRS 2.B43(c)*]

4.5.1280 Modification of service condition

4.5.1280.10 If a service period is reduced, then the entity uses the modified vesting period when applying the requirements of the modified grant-date method. In the period of change, the entity calculates the cumulative amount to be recognised at the reporting date based on the new vesting conditions. [*IFRS 2.B43(c)*]

Example 16 – Share-based payment with modified service condition

4.5.1280.20 Company S grants an equity-settled share-based payment with a grant-date fair value of 1,000 subject to a five-year service period. At the beginning of year 3, the service period is reduced to four years. In this case, S calculates the cumulative amount to be recognised at the end of year 3 based on the new vesting period and recognises the difference to the amounts recognised in previous years ((1,000 x 3/4) - 400 = 350).

4.5.1280.30 If an employee leaves before vesting date, then an entity may respond by amending the terms of the share-based payment or granting a new award such that the award vests despite the employee not having completed the service period originally required. This fact pattern could be seen as a forfeiture of the original award and a grant of a new award. Forfeiture due to voluntary termination of employment by the employee would result in a true-up to zero of the original award. A grant of a new award would result in recognition of the new grant-date fair value immediately because no further services are provided. [*IFRS 2.27, B42, B43(c)*]

4.5.1280.40 In our view, if on termination of employment by either the employee or the employer, the employer accelerates the vesting period such that the employee receives the award despite not having completed the requisite service period, then this is a modification of the award and not a forfeiture of the original award (forfeiture would result in true-up to zero) and a grant of a new unrelated award (which would result in recognising the new grant-date fair value immediately because no further services are provided). This is because IFRS 2 illustrates an acceleration of the vesting period as an example of a modification that is beneficial to an employee. The accounting would be the same if the acceleration of vesting were treated as the forfeiture of the original grant and a grant of a replacement award. This is because the grant of a replacement award is also treated as a modification (see 4.5.1430). [*IFRS 2.27*]

start customisation until 1 June 2014, the commencement date of the lease is 1 May 2014 because this is the date on which the lessee is *entitled* to use the leased asset. [*IAS 17.4*]

5.1.50.20 The lease term includes the *non-cancellable* period of the contract and any further periods for which the lessee has an option to continue to lease the asset and for which, at the time of inception of the lease, it is judged reasonably certain that the lessee will exercise that option. A non-cancellable lease is a lease cancellable only on the occurrence of some remote contingency, with the permission of the lessor, if the lessee enters an equivalent lease, or on payment of a penalty such that continuation of the lease is reasonably certain. [*IAS 17.4*]

5.1.50.25 For example, if the lease term is nine years but the lessee can cancel the lease without penalty (and without the permission of the lessor) at the end of the third and sixth years, then the non-cancellable period of the contract would be three years. The substance of the arrangement is that at the end of the third and sixth years, the lessee has an option to extend the lease. If at the time of inception of the lease it is judged reasonably certain that the lessee will not cancel the lease and will effectively exercise its options to extend at the end of the third and sixth years, then the lease term will be nine years. [*IAS 17.4*]

5.1.50.30 IFRS does not provide specific guidance on how to assess when it should be considered 'reasonably certain' that a lessee would exercise an option to renew the lease. The assessment of the degree of certainty is based on facts and circumstances at inception of the lease rather than on the lessee's intentions. Factors relevant to the assessment may include, for example:

- the amount of the rentals payable in the secondary lease period compared with expected market rates for a similar asset during that period;
- the significance of continued use of the asset to the lessee's business model; and
- the ability of the lessee to recover costs that it incurs improving the leased asset.

5.1.50.40 In our view, if it is believed that a lessee will be economically compelled to renew a lease, then this indicates that renewal is reasonably certain. Conversely, if the lessee benefits from a modest discount on market rents in the secondary lease period, then this may increase the likelihood that the lessee will renew but, in the absence of other factors, will rarely demonstrate that renewal is reasonably certain.

5.1.60 Economic life and useful life

5.1.60.10 A leased asset's *economic* life is the period over which the asset is expected to be usable – e.g. by the current lessee and any subsequent user. The economic life is used when comparing the lease term with the asset's life to evaluate whether the lease is an operating or a finance lease (see 5.1.100). A leased asset's *useful* life, which may be shorter than its remaining *economic* life, is the period over which the economic benefits of the asset are expected to be consumed by the lessee. A lessee depreciates an asset capitalised under a finance lease over the shorter of the *lease term* and the asset's *useful* life, unless it is reasonably certain that the lessee will obtain ownership by the end of the lease term, in which case the depreciation period is the useful life. [*IAS 17.4, 28*]

5.1.60.20 In our view, when an asset that was previously leased subsequently becomes the subject of a new lease, the economic life of the asset for the purpose of assessing the lease classification of the new lease is the *remaining* economic life of the asset measured from the *commencement date* of the

new lease. If there is no modification to the original lease, then basing the classification on the leased asset's existing condition more accurately reflects the substance of the lease economics. [*IAS 17.4*]

EXAMPLE 2 – NEW LEASE CLASSIFICATION – ECONOMIC LIFE VS USEFUL LIFE

5.1.60.30 Company L leases a new asset with an economic life of 10 years to Company M under a five-year lease with no option for renewal. At the end of the lease term, the remaining economic life of the asset is assessed as seven years. Following expiry of the initial lease, L grants M a new five-year lease over the asset. The new lease does not contain a bargain purchase option and title does not transfer at the end of the lease term. For the purpose of determining the lease classification for the lessee, we believe that the economic life is seven years and that the contract life is five years.

5.1.70 Residual values

5.1.70.10 There are two types of residual value to be considered by the parties to a lease contract: *guaranteed* residual value and *un-guaranteed* residual value. A 'guaranteed residual value' is the fixed or determinable amount that is required to be paid to the lessor at the end of the lease term or on disposal of the leased asset. An 'un-guaranteed residual value' is the amount that the lessor expects to recover from the leased asset following the end of the term; however, realisation of that amount is not assured by a party external to the lessor. [*IAS 17.4*]

5.1.70.20 The amount of the minimum lease payments reflects whether the residual value is guaranteed or un-guaranteed. The lessor includes in the determination of the minimum lease payments any residual value guaranteed by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee. The lessee includes a guaranteed residual value in the determination of the minimum lease payments only if the lessee or a party related to the lessee has guaranteed the residual value. For a lessee, the amount included in the minimum lease payments in respect of a residual value guarantee is the maximum amount that the lessee could, in any event, be required to pay. An un-guaranteed residual value is always excluded from the determination of the minimum lease payments, but is nevertheless part of the lessor's gross investment in a finance lease (see 5.1.330.10). [*IAS 17.4*]

5.1.70.30 For further discussion of residual value guarantees and third party guarantees, see 5.1.378.

5.1.80 Contingent rent

5.1.80.10 The guidance in this section on the application of contingent rentals in determining minimum lease payments applies equally to both operating and finance leases and both lessees and lessors. 'Contingent rent' is the portion of lease payments that is not fixed in amount. This definition specifically refers to *future* amounts that are not fixed because they are potential incremental payments linked to future changes in indices, sales, use of equipment etc. The calculation of minimum lease payments includes the lease payments that are known at the lease inception date, based on the then-current variable market rate or current price level. [*IAS 17.4*]

5.1.80.20 This can be illustrated by considering an 'interest-only' lease, in which the periodic lease payments are calculated by multiplying an underlying monetary amount by a market interest rate and, in addition, there is a final lease payment of the underlying monetary amount. In such cases, the

of potential ordinary shares of a subsidiary, associate or joint venture (investees) is determined based on a two-step approach.

- *Step 1:* They are included in diluted EPS of the investee. The impact on the investee's diluted EPS depends on the form of the instruments – e.g. if the instrument is an option, then the guidance in 5.3.270 is relevant.
- *Step 2:* The resulting diluted EPS of the investee is then included in the parent's or investor's diluted EPS based on the parent's or investor's holding of the instruments of the investee. [*IAS 33.40, A11, IE10*]

Example 19 – Potential ordinary shares issued by non-wholly owned subsidiary – Diluted EPS calculation

5.3.420.20 Company S is a subsidiary of Company P. The following facts in respect of S are relevant for this example.

- S has 10,000 ordinary shares and 1,000 options outstanding, of which P owns 9,000 and 500, respectively.
- The options have an exercise price of 40.
- The average market price of S's ordinary share was 50 in 2014.
- In 2014, S's profit was 30,000.

5.3.420.25 The following facts in respect of P are also relevant for this example.

- P has 5,000 ordinary shares outstanding.
- In 2014, P's profit (excluding any distributed and undistributed earnings of subsidiaries) was 7,000.

5.3.420.30 To determine the diluted EPS of P, the diluted EPS of S is calculated first.

S's diluted EPS = 30,000(1) / (10,000(2) + 200(3)) = 2.94

Notes
(1) S's earnings for the period
(2) Weighted-average ordinary shares
(3) Incremental shares related to weighted-average options outstanding. All options are dilutive because their exercise price is below the average market price of S's ordinary shares for the period. The incremental shares are calculated as follows.

Shares issued on assumed exercise of options	1,000
Less: shares that would be issued at average market price	(800)(i)
Incremental shares	200

(i) Calculated as assumed proceeds from exercise of 40,000 (40 x 1,000), divided by average market price of 50

5.3.420.40 Assuming that the options outstanding are dilutive at P's level (i.e. at the parent level), S's diluted EPS is then included in P's diluted EPS based on P's holding of S's equity instruments.

P's diluted EPS = (7,000(1) + 26,460(2) + 294(3)) / 5,000(4) = 6.75

Notes
(1) P's earnings for the period
(2) P's share of S's earnings attributable to ordinary shares – i.e. ((9,000 / 10,000) x (2.94 x 10,000))
(3) P's share of S's earnings attributable to options – i.e. ((500 / 1,000) x (2.94 x 200))
(4) P's weighted-average ordinary shares outstanding

5.3.420.50 In our view, the guidance in 5.3.420.10 also applies if options or warrants that entitle the holder to the ordinary shares of a subsidiary are issued by the parent rather than by the subsidiary itself.

5.3.420.60 Instruments of a subsidiary, associate or joint venture – e.g. convertible instruments or options – that may entitle their holders to the parent's or the investor's ordinary shares are considered among the potential ordinary shares of the parent or the investor. Their impact on the numerator or denominator depends on the form of the instruments – e.g. if they are convertible instruments, then the guidance in 5.3.240 is relevant. [*IAS 33.A11(b)*]

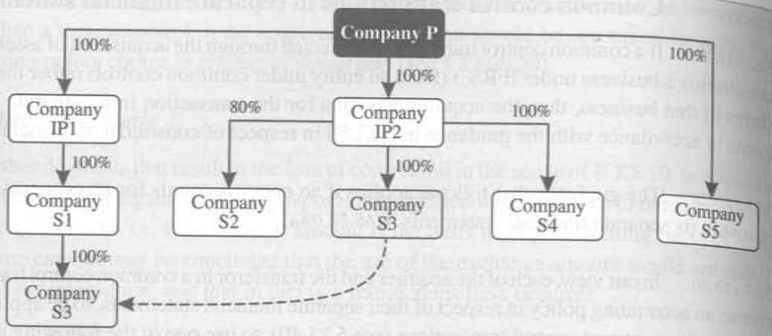
5.3.430 *Written put option over NCI*

5.3.430.10 In some circumstances, written put options may represent a (potential) obligation to purchase a subsidiary's equity instruments held by non-controlling shareholders (NCI puts) for cash or another financial asset. For these instruments, IAS 32 requires the parent to recognise a financial liability for the present value of the redemption price in its consolidated financial statements (see 7.3.190).

5.3.430.20 Although IAS 33 contains specific requirements on written puts on an entity's own ordinary shares (see 5.3.310), the EPS implications of NCI puts in the consolidated financial statements are less clear. This is because the guidance in paragraph A11 of IAS 33 that deals with instruments of subsidiaries, joint ventures or associates (see 5.3.420.10) does not address put options written on the shares of these entities. Therefore, in our view in determining its diluted EPS in the consolidated financial statements, an entity should choose an accounting policy, to be applied consistently, based on one of the following two approaches.

- *Approach 1:* Apply the guidance applicable to potential ordinary shares of a subsidiary (see 5.3.420.10) to NCI puts. This is on the basis that although paragraph A11(a) of IAS 33 does not address NCI puts, the approach that a subsidiary is required to apply to written put options on its own shares in accordance with paragraph 63 of IAS 33 should also be applied in the consolidated financial statements of the parent for NCI puts. Under this approach, it is assumed that the subsidiary would issue new shares to raise financing to buy the shares subject to the NCI put.
- *Approach 2:* Ignore the NCI puts. This is on the basis that paragraph A11(a) of IAS 33 does not address NCI puts. This approach does not assume that the subsidiary would issue new shares to raise financing to buy the shares subject to the put. Therefore, there would be no potential ordinary shares because once the NCI put is exercised the underlying shares would not be outstanding from the group's perspective. [*IAS 33.63, A10–A11*]

5.3.430.30 We believe that the accounting policy choice in 5.3.430.20 is available regardless of whether the NCI puts are written by the parent or the subsidiary – i.e. whether it is the parent or the subsidiary that has the obligation to settle. This is because economically, at a consolidated level, it makes no difference which group entity has written the instrument.



5.13.120.20 In applying *book value accounting*, the acquirer (S1) and the transferor (IP2) record the following entries, recognising the difference between the book value of the transferee (S3) and the consideration paid/received as an equity transaction with the shareholder (P) – i.e. as if S3 had been purchased for its book value of 100 and the difference of 20 paid back as a distribution made/contribution received.

	Debit	Credit
Entries in S1		
Investment in subsidiary (S3)	100	
Cash		80
Contribution (equity)		20
To recognise acquisition of S3		
Entries in IP2		
Cash	80	
Distribution (equity)	20	
Investment in subsidiary (S3)		100
To recognise disposal of S3		

5.13.120.30 In applying *fair value accounting*, the acquirer (S1) and the transferor (IP2) record the following entries, recognising the difference between the fair value of the transferee (S3) and the consideration paid/received as an equity transaction with the shareholder (P) – i.e. as if S3 had been purchased for its fair value of 130 and the difference of 50 paid back as a distribution made/contribution received.

	Debit	Credit
Entries in S1		
Investment in subsidiary (S3)	130	
Cash		80
Contribution (equity)		50
To recognise acquisition of S3		

	Debit	Credit
Entries in IP2		
Cash	80	
Distribution (equity)	50	
Investment in subsidiary (S3)		100
Profit or loss (see 5.13.120.12) (130 - 100)		30
To recognise disposal of S3		

5.13.120.40 In applying *exchange amount accounting*, the acquirer (S1) and the transferor (IP2) record the following entries, in the same way as if the transaction had been with a third party for the actual price paid.

	Debit	Credit
Entries in S1		
Investment in subsidiary (S3)	80	
Cash		80
To recognise acquisition of S3		
Entries in IP2		
Cash	80	
Profit or loss	20	
Investment in subsidiary (S3)		100
To recognise disposal of S3		

5.13.130 *Downstream transfers* Ⓢ

5.13.130.10 In a 'downstream transfer', a direct subsidiary of the transferor becomes an indirect subsidiary.

5.13.130.20 In a downstream transfer, the accounting in the acquirer's separate financial statements is unchanged from the accounting in a sideways transfer (see 5.13.120).

5.13.130.30 The accounting in the transferor's separate financial statements is affected because the transferee is now an indirect rather than a direct subsidiary of the transferor. In our view, there is no loss on such a transaction as the transferor does not lose any value. Accordingly, we believe that the transaction should be accounted for as follows.

- A surplus or deficit is computed in the same way as for a sideways transfer (see 5.13.120).
- The actual price received and the benchmark – i.e. book value, or fair value if fair value accounting is applied – are compared; any surplus in the price received is recognised as a dividend received and any deficit is recorded as an additional investment in the acquirer.