

Where an entity chooses to disclose additional information, full notes for that information are needed to ensure that the additional information is balanced and results in financial statements that achieve a fair presentation. [IAS 1 para BC32F].

4.51 Where it is impracticable to restate the comparative figures, then the entity should disclose the reason for not restating and the nature of the adjustments that would have been made if it had been practicable to do so. [IAS 1 para 42]. Applying a requirement is 'impracticable' when the entity cannot apply it after making every reasonable effort to do so. [IAS 1 para 7]. It is recognised that in some cases, such as when the data for the previous period has not been and cannot be collected in such a way as to permit reclassification, it will be necessary to depart from the normal rule and not reclassify. [IAS 1 para 43].

Consistency of presentation

4.52 IFRS requires entities to present the financial statements in a consistent manner. IAS 1 states:

"An entity shall retain the presentation and classification of items in the financial statements from one period to the next unless:

- (a) *it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for selection and application of accounting policies in IAS 8; or*
- (b) *an IFRS requires a change in presentation."*

[IAS 1 para 45].

4.53 Once management has selected a particular presentation, they should use it consistently. Most companies will seldom have good reason to change their presentation and, therefore, they should give careful consideration to the presentation that they wish to adopt when they prepare their first set of financial statements after incorporation or on transition to IFRS. Unless a standard or interpretation requires a change in presentation, an entity may only change its presentation if the changed presentation provides reliable and more relevant information; that is, the new presentation should be an improvement on the previous presentation. Just as entities should not change an accounting policy to another acceptable, but not improved, accounting policy, they should not change presentation to another acceptable, but not improved presentation. To ensure comparability, entities should only change to a presentation that is likely to continue to be used in future periods so that comparability is not impaired. [IAS 1 para 46].

4.54 Where an entity changes its presentation or classification of items, the notes to the financial statements should disclose the nature, amount of, and reason for the reclassification. [IAS 1 para 41]. As noted above, in the rare circumstances

when it is impracticable to restate the corresponding amounts, disclosures are still required in these cases (see further para 4.51). The requirement for a statement of financial position to be presented as at the beginning of the earliest comparative period when items are reclassified is discussed in paragraph 4.46 above.

[The next paragraph is 4.56.]

Structure and content

4.56 IAS 1 requires certain disclosures to be made on the face of the primary statements; other required disclosures may be made in the notes or on the face of the financial statements, unless another standard specifies otherwise. [IAS 1 paras 47, 48].

Identification

4.57 As noted in paragraph 4.15, IAS 1 requires the financial statements to be identified and distinguished from other information in the same published document. It is important for users of financial statements to understand the information that is presented in accordance with IFRS and other information that is supplementary to those financial statements. [IAS 1 paras 49, 50]. It is also important for the audited IFRS-compliant financial statements to be distinguished from unaudited information that may or may not be in compliance with IFRS. The use of alternative measures of performance, often referred to as 'non-GAAP measures', has been of concern to many financial statement readers, particularly regulators in North America and Europe. At times, such measures appear to give a more flattering picture of the entity's performance than the profit or loss determined in accordance with IFRS. Entities should exercise care when presenting alternative performance measures in their published documents to ensure they are distinguished from the financial statements themselves. See also from paragraph 4.238.

4.58 IAS 1 also contains the following requirements:

"An entity shall clearly identify each financial statement and the notes. In addition, an entity shall display the following information prominently, and repeat it when necessary for the information presented to be understandable:

- (a) *the name of the reporting entity or other means of identification, and any change in that information from the end of the preceding reporting period;*
- (b) *whether the financial statements are of an individual entity or a group of entities;*
- (c) *the date of the end of the reporting period or the period covered by the set of financial statements or notes;*
- (d) *the presentation currency, as defined in IAS 21; and*

investments in associates and other similar transactions, nor to combinations of put and call options that are in some ways similar to a forward (sometimes referred to as 'synthetic forwards').

Own equity instruments

6.1.22 Financial instruments issued by an entity, including options and warrants, that meet the definition of an equity instrument in IAS 32 or are required to be classified as equity in accordance with paragraphs 16A, 16B, 16C and 16D of IAS 32, are outside IAS 39's but inside IAS 32's scope. Such instruments, along with other equity accounts including retained earnings, represent the residual interest of the reporting entity and are, therefore, subject to different measurement considerations to those relevant to financial assets and financial liabilities. However, the holder (but not issuer) of such an instrument should apply IAS 39 unless it meets the exceptions discussed in paragraphs 6.1.16 to 6.1.19 above. [IAS 39 para 2(d)]. IFRS 7 deals with disclosures of financial instruments in general and doesn't scope out issuers' own equity instruments, for example, disclosure about compound financial instruments in paragraph 17 of IFRS 7; although it does scope out instruments that are required to be classified as equity in accordance with paragraphs 16A, 16B, 16C and 16D of IAS 32. [IFRS 7 para 3(f)].

Rights and obligations under lease contracts

6.1.23 Finance lease contracts that give rise to financial assets for lessors and financial liabilities for lessees are financial instruments that are specifically dealt with in IAS 17. Therefore, they fall within the scope of IAS 32 and IFRS 7, but outside of IAS 39's scope, except as follows:

- Lease receivables are included in IAS 39's scope for derecognition and impairment purposes only.
- Finance lease payables are subject to IAS 39's derecognition provisions.
- Any derivatives embedded in lease contracts are also within IAS 39's scope. [IAS 39 para 2(b)].

Rights and obligations under insurance contracts

6.1.24 An insurance contract is a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder. [IFRS 4 App A]. Principally, rights and obligations under insurance contracts are scoped out of IAS 32, IFRS 7 and IAS 39 and are accounted for under IFRS 4, because the policyholder transfers to the insurer significant insurance risk rather than financial risk. [IAS 32 para 4(d); IFRS 7 para 3(d); IAS 39 para 2(e)]. Financial risk is the risk of a possible future change in one or more of a specified interest rate, financial

instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. [IFRS 4 App A]. If a financial instrument takes the form of an insurance contract, but involves the transfer of financial risks, as opposed to insurance risk, the contract would fall within the financial instrument standards. The distinction between insurance risk and other risks are set out in Appendix B to IFRS 4. [IFRS 4 App B paras 8-17]. IFRS 4 contains numerous examples of insurance contracts that fall within IFRS 4's scope and those that are not insurance contracts and may fall within the scope of IAS 32, IFRS 7 and IAS 39. [IFRS 4 App B paras 18-19] IFRS 7 provides disclosure only for those rights and obligations under insurance contracts that are also in IAS 39's scope. [IFRS 7 para 3(d)].

Contracts with discretionary participating features

6.1.25 Financial instruments that are within IFRS 4's scope, because they contain a discretionary participation feature are also scoped out of IAS 39. A discretionary participation feature is a contractual right to receive significant additional benefits, as a supplement to guaranteed benefits, whose amount or timing is at the issuer's discretion and that are contractually based on the performance of a specified pool of contracts, investment returns or profit or loss of the company, fund or other entity that issues the contract. [IFRS 4 App A]. However, these instruments are in IFRS 7's scope and subject to the requirements of IAS 32 except for those with respect to the distinction between financial liabilities and equity instruments. [IAS 32 para 4(e); IAS 39 para 2(e)].

Derivatives embedded in insurance contracts

6.1.26 Derivatives embedded in insurance contracts or in contracts containing discretionary participating features as discussed above are within the scope of IAS 32, IFRS 7 and IAS 39 if they require separation in accordance with IAS 39. [IAS 39 para 2(e); IAS 32 para 4(d) (e); IFRS 7 para 3((d)); IFRS 4 paras 7, 34(d)]. For example, separate accounting would be required in circumstances where contractual payments embedded in a host insurance contract that is indexed to the value of equity instruments are not related to the host instrument, because the risks inherent in the host and the embedded derivative are dissimilar. [IAS 39 para AG 30(d)]. However, no separation is required if the embedded derivative itself is an insurance contract. [IAS 39 para 2(e); IFRS 4 para 7].

Financial guarantee contracts

6.1.27 Financial guarantee contracts (sometimes known as 'credit insurance') require the issuer to make specified payments to reimburse the holder for a loss it incurs if a specified debtor fails to make payment when due under a debt instrument's original or modified terms. [IAS 39 para 9]. That is, the holder is exposed to and has incurred a loss on the failure of the debtor to make payments.

of the contractual terms of financial liabilities, that may result in derecognising the liability and recognition of an equity instrument is dealt with in chapter 6.6.

6.5.15 The IFRS IC issued rejection wording in November 2006 that clarified the accounting treatment for transfers from equity to liability when the transfer is a result of a change in the instrument's contractual terms. This might be, for example a change in the contractual terms to require a coupon, which was previously at the discretion of the issuer, to be paid on the occurrence of a genuine contingent settlement event, which is outside the control of both the issuer and the holder. The IFRS IC clarified that a financial liability is initially recognised at the time when the contractual terms are changed, irrespective of whether the change affects the contractual cash flows. The new liability is measured at fair value in accordance with paragraph 43 of IAS 39.

6.5.16 The IFRS IC also observed that the change in the instrument's terms gives rise to derecognising the original equity instrument. No gain or loss is recognised in profit and loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. [IAS 32 para 33]. The difference between the carrying amount of the equity instrument and the fair value of the newly-recognised financial liability is recorded in equity at the time the terms are changed. This applies even if the change in terms has no impact on the instrument's expected cash flows.

6.5.17 The guidance is not clear on whether an entity should reclassify an instrument if the contractual terms have not changed. IAS 32 is silent on whether a re-assessment is required after initial recognition as paragraph 15 of IAS 32 only prescribes that an entity should classify the instrument, or its component parts, on initial recognition. Therefore, it is possible to argue that an instrument should not be reclassified after inception. On the other hand, paragraph 39 of IAS 39 states that an entity should remove a financial liability (or a part of a financial liability) from its balance sheet when, and only when, it is extinguished; that is when the obligation specified in the contract is discharged or cancelled or expires. Therefore, one could argue that if the contractual obligation that triggered liability classification terminates, then reclassification is appropriate because the obligation has been discharged or cancelled. We believe that both treatments can be supported; an entity should determine an appropriate accounting policy and apply it consistently.

Example – potential reclassification of an instrument from financial liability to equity

An entity issues a 5 year convertible bond where the holder has the option to convert it into the issuer's equity shares after the first year, but where the conversion ratio is only fixed at the end of the first year at the lower of CU5 and 130% of the equity share price. As the number of shares the bond could be converted into is variable, on initial recognition the conversion option is recognised as a separate embedded derivative liability. However, at the end of year one, under the contract's original terms, the conversion ratio is fixed and, therefore, no longer meets the definition of a financial liability. In considering the guidance in IAS 32 above, the change in the conversion ratio from variable to fixed at the end of year 1 would not result in reclassification

because the assessment would be based only on the terms at inception of the contract. Alternatively, in considering the guidance in IAS 39, the conversion option would be reclassified from a derivative liability to equity, because the obligation to deliver a variable number of shares upon conversion expires and the obligation to then deliver a fixed number of shares meets the definition of equity.

6.5.18 Where an entity elects to reclassify an instrument in accordance with paragraph 6.5.17, we believe that an entity has an accounting policy choice in how to account for the change in classification. An entity can apply the same accounting treatment as when convertible debt is converted into shares (see para 6.5.96) where the existing debt's carrying value is transferred to equity and no gain or loss arises on conversion. Alternatively, the exchange of an existing debt instrument of the issuer with new equity instruments could be viewed, in substance, as an extinguishment of the existing financial liability (as covered by chapter 6.6). So the original debt instrument is derecognised, and the new equity instruments issued are recognised at fair value. The difference between this amount and the carrying amount of the derecognised financial liability is recognised as a gain or loss in profit or loss in accordance with IFRIC 19 and paragraph 41 of IAS 39.

6.5.19 Reclassifications of puttable instruments and obligations arising on liquidation are dealt with from paragraph 6.5.40.

Contracts that are settled in cash or another financial asset

Contractual obligation to settle in cash or another financial asset

6.5.20 The critical feature that distinguishes a liability from an equity instrument is the existence of a contractual obligation to deliver cash or another financial asset to the holder or to exchange a financial asset or financial liability with the holder under conditions that are potentially unfavourable to the issuer. In other words, if the issuer does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, the obligation meets the definition of a liability, with the limited exception of puttable instruments and obligations arising on liquidation that meet the strict criteria set out from paragraph 6.5.27.

6.5.21 An instrument that an issuer may be obliged to settle in cash or another financial instrument is a liability regardless of the manner in which it otherwise could be settled. For example, the obligation to deliver cash may cover the basic obligation either to repay the principal or interest/dividends or both. Also, the obligation need not be discharged in cash or another financial asset; it could be discharged by transfer of other kinds of assets in certain circumstances (for example, a property) as illustrated in paragraph 6.5.45 below. Indeed, in some circumstances it can even be settled by the issuer's own equity instruments. As long as the instrument involves a contractual unconditional obligation to deliver cash or another financial asset, that instrument (or component of the instrument) should be classified and accounted for as a liability (with the exception of certain

6.6.75 Where the transferor writes a put option or provides a guarantee of the original asset, the transfer will also often fail the control test. In such situations, the transferee has effectively obtained two assets: the original asset that is the subject of the transfer, and the put option or the guarantee. Selling the transferred asset on its own invalidates the remaining asset, as the transferee immediately loses any ability to realise its value. In the absence of an active market, the transferee will only be able to realise the asset's value by selling a similar guarantee or put option with the assets. Put another way, if the put option or guarantee is valuable enough for significant risk to be retained by the transferor, it precludes the transfer of control. That is, it will be so valuable to the transferee that the transferee would not, in practice, sell the transferred asset to a third party without attaching a similar option or guarantee, or otherwise mirroring the conditions attached to the original transfer. As the transferee is constrained from selling the asset without attaching additional restrictions, the 'practical ability' to sell test fails, with the result that control of the transferred asset is retained by the transferor. [IAS 39 para AG44].

6.6.76 If the transferee has the practical ability to sell the transferred asset, the transferee has control over the asset. Hence the transferor has lost control and derecognises the asset. On the other hand, if the transferee does not have the practical ability to sell the transferred asset, the transferor has retained control of the transferred asset and continues to recognise the asset to the extent of its continuing involvement.

6.6.77 The 'control' concept is important because it helps determine how the transferor's remaining interest in the asset will be presented. If the transferor has retained control, it still has an interest in the specific assets that have been transferred. It should, therefore, continue to show that interest on the balance sheet, gross of any related liability. If control has been lost, the transferor still shows its remaining economic interest on the balance sheet, but presented net. This recognises that the transferor's interest is a net exposure (that is, more akin to a derivative) rather than an interest directly related to the specific assets that have been transferred.

Continuing involvement in transferred asset

6.6.78 The continuing involvement approach applies if the entity has neither transferred nor retained substantially all the risks and rewards of ownership and control has not passed to the transferee. Under the continuing involvement approach, the entity continues to recognise part of the asset. That part represents the extent of its continuing exposure to the risks and rewards of the financial asset. That is, the continuing involvement includes both obligations to support the risks arising from the asset's cash flows (for example, if a guarantee has been provided) and the right to receive benefits from these cash flows. In these circumstances a related liability is recognised, as well as part of the original asset.

6.6.79 Warranties, contractual credit notes and two-party offset arrangements are not taken into account in measuring an entity's continuing involvement for

the reasons discussed in paragraphs 6.6.45, 6.6.61 and 6.6.62. On the other hand, options or commitments to repurchase the transferred assets on a change in circumstances – for example, a change in tax law/regulation – should be taken into account in measuring the entity's continuing involvement. For example, an entity has sold receivables to a factor. Within the terms of the sale agreement, if there is a change in the tax law/regulation, the entity has the option (or commitment) to repurchase the transferred assets from the factor at par. Such right (or commitment) is related specifically to a particular receivable and, therefore, should be taken into account in measuring the entity's continuing involvement. If the option (or commitment) is to repurchase any receivable, the continuing involvement asset would be the entire group of receivables – that is, no derecognition would be achieved. Continuing involvement is addressed further from paragraph 6.6.145.

Accounting by transferee

6.6.80 Although transferees are required to follow the recognition principles discussed from paragraph 6.6.6 above, it is important to note that the accounting treatment between the transferor and the transferee is intended to be symmetrical. Therefore, to the extent that a transfer of a financial asset does not qualify for derecognition, the transferee does not recognise the transferred asset as its asset. The transferee derecognises the cash or other consideration paid and recognises a receivable from the transferor. If the transferor has both a right and an obligation to re-acquire control of the entire transferred asset for a fixed amount (such as under a repurchase agreement), the transferee may classify it's receivable as a 'loan and receivable'. [IAS 39 para AG 50]. Similarly, if a transfer of a financial asset qualifies for derecognition, the transferor will treat it as a sale and the transferee will treat it as a purchase.

Disclosure

6.6.81 IFRS 7 sets out specific disclosure requirements for transfers that do not qualify for derecognition; these are addressed in chapter 6.9. However, paragraph 118 of IAS 1 also requires an entity to disclose the significant accounting policies that are relevant to an understanding of the financial statements. It requires an entity to disclose the judgements that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. This will include any significant accounting policy choices and judgements it has made in relation to derecognition, for example:

- What the entity regards as a transfer of contractual rights for the purposes of paragraph 18(a) of IAS 39 as discussed in paragraph 6.6.39 above.
- What the entity regards as the 'original asset' for the purpose of paragraphs 19(a) and 20 of IAS 39 as discussed in paragraph 6.6.56 above.

All-in-one hedges

6.8.84 Under IAS 39, a derivative can be an instrument which is settled gross by delivery of the underlying asset and the payment of the price specified in the contract rather than by net settlement of the difference between the two legs. The implementation guidance states that such an instrument can be designated as a hedging instrument in a cash flow hedge of the variability of the consideration to be paid or received in the future transaction that will occur on gross settlement of the derivative contract itself, assuming the other cash flow hedge accounting criteria are met. Without the derivative, there would be an exposure to variability in the purchase or sale price. As the derivative eliminates the exposure, it qualifies as a hedging instrument. This applies to all fixed price contracts that are accounted for as derivatives under IAS 39.

Example – Gross settled derivative designated as an ‘all-in-one hedge’

An entity enters into a forward contract to purchase a bond that will be settled by delivery. The forward contract is a derivative, because its term exceeds the regular way delivery period in the marketplace.

The entity may designate the forward as a cash flow hedge of the variability of the consideration to be paid to acquire the bond (a future transaction), even though the derivative is the contract under which the bond will be acquired. [IAS 39 para F2.5].

6.8.85 Such ‘all-in-one hedge’ accounting strategy can be beneficial to entities. For instance, if an entity enters into a fixed price contract to buy a commodity that falls to be accounted for as a derivative under IAS 39, the contract would be recognised at fair value with gains and losses recognised in profit or loss. By applying an all-in-one hedge accounting strategy, the entity is able to defer gains and losses on the hedging instrument in equity under cash flow hedge accounting until the hedged transaction occurs. In other words, the entity is able to keep gains and losses from being recognised in profit or loss on what is effectively a fixed price purchase or sale commitment.

6.8.85.1 A question arises as to whether it is possible to achieve an all-in-one hedge when there is some variability in the contractual cashflows for the reporting entity. In our view, any variables that would have been closely related if the contract could have been accounted for as an executory contract outside the scope of IAS 39 should not prevent the otherwise fixed price contract being designated as an all-in-one hedge, provided that it can be documented that the hedge is expected to be highly effective. For example, a non-executory contract to purchase a commodity at a future date at a fixed price denominated in the counterparty’s functional currency could be eligible to be designated as an all-in-one hedge.

Internal hedging instruments

6.8.86 Entities with sophisticated central treasury functions often use internal hedging transactions to ‘transfer’ interest rate and currency risk to the group treasury. For instance, central treasury may enter into internal derivative contracts such as forward contracts and swaps with subsidiaries and various divisions of a consolidated group with the objective of ‘converting’ all financial assets and liabilities of those operating units to variable rate instruments in the reporting currency. Central treasury will assess its exposure to various currencies and to interest rate risk and enter into external forward contracts and swaps to manage those risks on a centralised basis, thereby generating economies of scale and pricing efficiency.

6.8.87 Consistent with paragraph 6.8.39 above, internal derivative contracts used to transfer risk exposures between different companies within a group or divisions within a single legal entity cannot be designated as hedging instruments if the derivative contracts are *internal* to the entity being reported on. It follows that internal derivative contracts cannot be designated as hedging instruments in the consolidated financial statements. Nor can they be designated as hedging instruments in the individual or separate financial statements of a legal entity for hedging transactions between divisions in the entity. IAS 39 makes it clear that only instruments that involve a party external to the reporting entity (that is, a group, or an individual entity that is being reported on) can qualify as designated hedging instruments.

6.8.88 However, if an internal contract is offset with an external party, the external contract may be regarded as the hedging instrument and the hedging relationship may qualify for hedge accounting. [IAS 39 para IG F1.4]. In such situations, the hedging relationship consists of the external instrument and the item that was the subject of the internal hedge. The internal derivative is often used as a tracking mechanism to relate the external derivative to the hedged item. Indeed, many entities take advantage of this provision in IAS 39 that allows them to net risk through a central treasury centre and thereafter hedge the net exposure by entering into external contracts with third parties. This avoids the cost of each subsidiary entering into contracts with third parties, some of which may duplicate each other. The following example illustrates the situations described above.

Example – Internal derivative contracts

The banking division of Entity A enters into an internal interest rate swap with the trading division of the same entity. The purpose is to hedge the interest rate risk exposure of a loan (or group of similar loans) in the loan portfolio. Under the swap, the banking division pays fixed interest payments to the trading division and receives variable interest rate payments in return.

If a hedging instrument is not acquired from an external party, IAS 39 does not allow hedge accounting treatment for the hedging transaction undertaken by the banking and trading divisions. This is because only derivatives that involve a party external to the entity can be designated as hedging instruments. [IAS 39 para 73]. Furthermore,

6.9.87 The disclosures require quantitative information about recognised financial instruments that are offset in the statement of financial position, as well as those recognised financial instruments that are subject to master netting or similar arrangements irrespective of whether they are offset. [IFRS 7 para 13A]. Similar arrangements include derivative clearing agreements, global master repurchase agreements, global master securities lending agreements and any related rights to financial collateral. Examples of financial instruments that are not within the scope of the new disclosures are loans and customer deposits at the same institution (unless they are set off in the statement of financial position) and financial instruments that are subject only to a collateral agreement. [IFRS 7 para B41].

6.9.88 Paragraph 13B of IFRS 7 sets out the objective for the offsetting disclosures: it requires an entity to disclose information that enables users of its financial statements to evaluate the effect or potential effect of netting arrangements on its financial position.

6.9.89 To meet this objective, paragraph 13C of IFRS 7 requires an entity to disclose at the end of each reporting period the following quantitative information separately for recognised financial assets and recognised financial liabilities that are within the scope:

- (a) the gross amounts of those recognised financial assets and recognised financial liabilities;
- (b) the amounts that are set off in accordance with the criteria in paragraph 42 of IAS 32 when determining the net amounts presented in the statement of financial position;
- (c) the net amounts presented in the statement of financial position;
- (d) the amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 13C(b) of IFRS 7, including:
 - (i) amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria in paragraph 42 of IAS 32; and
 - (ii) amounts related to financial collateral (including cash collateral); and
- (e) the net amount after deducting the amounts in (d) from the amounts in (c) above.

[IFRS 7 para 13C].

The information set out above should be presented in a tabular format, separately for financial assets and financial liabilities, unless another format is more appropriate. [IFRS 7 para 13C].

6.9.90 It is possible that financial instruments disclosed under the above requirements are measured differently – for example, a payable related to a repurchase agreement may be measured at amortised cost, while a derivative will

be at fair value. Entities include financial instruments at recognised amounts and describe resulting measurement differences in the related disclosures.

- 6.9.91 The 'gross amounts' required by paragraph 13C(a) relate to both:
- recognised financial instruments that are set off in accordance with paragraph 42 of IAS 32; and
 - recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement irrespective of whether they meet the offsetting criteria.

However, the 'gross amounts' required by paragraph 13(a) do not relate to any amounts recognised as a result of collateral agreements that do not meet the offsetting criteria in para 42 of IAS 32. Instead, such amounts are disclosed in accordance with paragraph 13C(d). [IFRS 7 para B43].

6.9.92 With regards to the 'amounts that are set off' when determining the 'net amounts' as required by paragraph 13C(b), the amounts of both the recognised financial assets and the recognised financial liabilities that are subject to set-off under the same arrangement are disclosed in both the financial asset and financial liability disclosures. However, the amounts disclosed (in, for example, a table) are limited to the amounts that are subject to set-off. For example, an entity may have a recognised derivative asset and a recognised derivative liability that meet the offsetting criteria in paragraph 42 of IAS 32. If the gross amount of the derivative asset is larger than the gross amount of the derivative liability, the financial asset disclosure table will include the entire amount of the derivative asset (in accordance with para 13C(a)) and the entire amount of the derivative liability (in accordance with para 13C(b)). However, while the financial liability disclosure table will include the entire amount of the derivative liability (in accordance with para 13C(a)), it will only include the amount of the derivative asset (in accordance with para 13C(b)) that is equal to the amount of the derivative liability. [IFRS 7 para B44].

6.9.93 With regards to the disclosure of 'net amounts' in the statement of financial position as required by paragraph 13C(c), paragraph B45 of IFRS 7 clarifies the following: If an entity has instruments that meet the scope of these disclosures (as specified in para 13A) but that do not meet the offsetting criteria in paragraph 42 of IAS 32, the amounts required to be disclosed by paragraph 13C(c) would equal the amounts required to be disclosed by paragraph 13C(a). Furthermore, the 'net amounts' required to be disclosed by paragraph 13C(c) must be reconciled to the individual line item amounts presented in the statement of financial position. For example, if an entity determines that the aggregation or disaggregation of individual financial statement line item amounts provides more relevant information, it must reconcile the aggregated or disaggregated amounts disclosed in paragraph 13C(c) back to the individual line item amounts presented in the statement of financial position. [IFRS 7 para B45 and B46].

- The costs incurred or to be incurred in respect of the sale can be measured reliably (see para 9.43).

[IAS 18 para 14].

9.34 When the outcome of transactions involving the rendering of services can be estimated reliably, revenue should be recognised by reference to the transaction's stage of completion at the balance sheet date. The transaction's outcome can be estimated reliably when all the following conditions are satisfied:

- The amount of revenue can be measured reliably (see para 9.40).
- It is probable that the economic benefits associated with the transaction will flow to the entity (see para 9.49).
- The transaction's stage of completion at the balance sheet date can be measured reliably (see para 9.106).
- The costs incurred and the costs to complete the transaction can be measured reliably (see para 9.43).

[IAS 18 para 20].

9.35 Revenue arising from the use by others of the entity's assets yielding interest, royalties and dividends should be recognised when:

- It is probable that the economic benefits associated with the transaction will flow to the entity (see para 9.49).
- The amount of the revenue can be measured reliably (see para 9.40).

[IAS 18 para 29].

9.36 The following conditions are common to the sale of goods, rendering of services and the recognition of interest, royalties and dividends:

- Reliable measurement of consideration.
- Probability that the economic benefits from the transaction will flow to the entity.

9.37 Reliable measurement of the costs incurred or to be incurred is common to the sale of goods and rendering of services.

9.38 In addition to the recognition criteria above, a signed contract should normally be in place between the vendor and the customer to support the recognition of revenue. This is because the contract drives key issues such as measurement of consideration, and the probability of economic benefits flowing to the vendor. However, in some cases it may be possible to recognise revenue before the sales contract has been signed if all key terms and conditions are agreed upon by both parties, for example where a master agreement is in place and criteria in paragraphs 14 and 20 of IAS 18 have been satisfied. Before recognising

revenue in such a situation, the entity should consider the likelihood of the contract being amended before it is signed. If the content of any potential amendments is unknown, it becomes difficult to establish whether the recognition criteria have been met. This may be the case even if certain elements of the contract appear to have already been delivered as, without knowing all obligations under the contract, it will not be possible to allocate the appropriate amount of revenue to the elements already performed or to know if delivered items might be returned.

9.39 The three conditions highlighted in paragraphs 9.36 and 9.37 above that are common to both the sale of goods and the rendering of services are discussed in more detail below. Conditions specific to the sale of goods are discussed from paragraph 9.57 onwards and condition specific to the sale of services are discussed from paragraph 9.106 onwards.

Reliable estimate of revenue

9.40 IAS 18 discusses the conditions necessary for a reliable estimate to be made of revenue for the rendering of services, but the three conditions below, suitably adapted, are equally valid for the sale of goods and use by others of the entity's assets. The standard states that the entity should have agreed the following with the other party for the sale of services:

- Each party's enforceable rights relating to the services to be provided under the contract.
- The consideration payable and receivable.
- The manner and terms of settlement.

[IAS 18 para 23].

9.41 To make reliable estimates the entity should normally have an effective system of internal budgeting and reporting. Estimates should be reviewed and, where necessary, revised as the contract for services is performed. However, such revisions do not necessarily indicate that the outcome of the contract cannot be reliably measured. [IAS 18 para 23].

9.42 The seller must also be able to reliably estimate any discounts or rebates offered in conjunction with the product to determine the revenue to be recognised for the sale of goods and services (see paras 9.84 and 9.85).

Reliable measurement of costs

9.43 Costs incurred for the sale of goods produced by the entity are generally the manufacturing costs, which are calculated in accordance with IAS 2 (see chapter 20). Where goods are purchased for resale the costs generally comprise all costs of purchase. Measurement of each of these types of cost is usually relatively straightforward for an established business that is offering an existing product. It can be more difficult for a new business or an entity selling a new product. Costs

The calculation of the revenue's fair value is given in the following table:

Progress billings invoiced:	Year 1	Year 2	Year 3		Discount factor	Discounted value (C)
	Discount factor	Discounted value (C)	Discount factor	Discounted Value (C)		
Year 1: 50,000	0.91573	45,787	0.95694	47,847	1	50,000
Year 2: 60,000	n/a	n/a	0.95694	57,416	1	60,000
Year 3: 90,000	n/a	n/a	n/a	n/a	1	90,000

The results that management should report are as follows:

	Year 1 (C)	Year 2 (C)	Year 3 (C)
Revenue	45,787	57,416	90,000
Interest income (accretion of discount)	-	2,060 ^a	4,737 ^b
Notes			
(a) Accretion of discount calculated $47,847 - 45,787 = 2,060$.			
(b) Accretion of discount calculated $(50,000 - 47,847) + (60,000 - 57,416) = 4,737$.			

9.315 A 'variation' is an instruction by the customer for a change in the scope of the work to be performed under the contract. Examples are changes in the specification or design of an asset and changes in the contract's duration. A variation is included in contract revenue when:

- it is probable that the customer will approve the variation and the amount of revenue arising from the variation; and
- the amount of revenue can be reliably measured.

[IAS 11 para 13].

9.316 A 'claim' is an amount that the contractor seeks to collect from the customer or another party as reimbursement for costs not included in the contract price. A claim may arise from, for example, errors in the initial specifications, delays caused by the customer or disputed variations. The settlement of claims arising from circumstances not envisaged in the contract or arising as an indirect consequence of approved variations is subject to a high level of uncertainty relating to the outcome of future negotiations. In view of this, claims are included in contract revenue only when:

- negotiations have reached an advanced stage such that it is probable that the customer will accept the claim; and
- the amount of the claim that the customer will probably accept can be reliably measured.

[IAS 11 para 14].

9.317 In practice, because of the frequency and large number of disputes that arise on construction contracts and the length of time over which negotiations may stretch, it is often more appropriate to take variations and claims into account only when they have actually been approved by the customer. The following table considers whether contract revenue should be recognised for certain claims and variations.

Variation or claim	Contract revenue recognised?
At the year end the following variations and claims occurred on a contract:	
(a) The customer approved changes to the contract's design specifications with a total cost of C5,000.	Yes, all criteria set out in paragraph 13 of IAS 11 are met. The C5,000 can be included in the contract price (revenue).
(b) Due to poor weather, the contract will overrun by 3 months. This will lead to an increase in costs of C3,000. The customer will probably not approve the amount of revenue arising from the variation.	No, the customer will probably not approve the variation amount. The additional costs already incurred should be included in the calculation of work in progress, if the contract is still profitable. However, a lower expected profit margin should be recognised because of the additional costs incurred. The total expected loss should be recognised immediately if the additional costs will result in a loss on the contract. For recognition of losses on contracts see paragraph 9.333.
(c) Due to unforeseen circumstances the contractor incurred additional costs in the current year on the contract. Negotiations to obtain the customer's acceptance of these claims are in early stages.	No, negotiations have not reached an advanced stage where it is probable that the customer will accept the claim. The contractor should include the additional costs in the work in progress calculation and recognise a lower expected profit margin due to the additional costs incurred.
(d) The customer will probably accept a claim of C2,000 due to delays caused by the customer itself.	Yes, all criteria set out in paragraph 14 of IAS 11 are met. The C2,000 can be included in the contract price (revenue).

9.318 'Incentive payments' are additional amounts that the customer pays to the contractor if certain specified performance targets or standards are met. An example is a payment for completing a contract ahead of schedule. Incentive payments are included in contract revenue when:

- the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and

Defined contribution plans

Recognition and measurement

11.92 Accounting for defined contribution plans is straightforward, as the amount recognised as an expense is the contribution payable. Except for contributions outstanding or pre-paid, an employer has no assets or liabilities in respect of a defined contribution plan. [IAS 19 para 51].

11.93 Contributions that are payable more than 12 months after the end of the period to which they relate, should be discounted using the rate specified in paragraph 11.138. [IAS 19 para 52].

11.94 An employer might contribute, or be obliged to contribute, an amount to an employee's defined contribution plan that vests over a certain period subsequent to the contribution. If the employee leaves within that period prior to vesting, the employer is entitled to a refund of the contribution, or its then investment value. In July 2011, the IFRS IC issued an agenda decision that clarifies the effect of vesting conditions on the accounting for such defined contribution arrangements (as defined in para 50 of IAS 19). The IFRS IC concluded that each contribution to a defined contribution plan is recognised as an expense or recognised as a liability (accrued expense) over the period of service that obliges the employer to make the contribution to the plan. This means that the expense would be recognised once the contribution is made (or the obligation to make the contribution arises) rather than over the subsequent vesting period. In their conclusion, the IFRS IC made a distinction between the period that creates the employer's obligation and the period of service that entitles an employee to receive the benefit from the defined contribution (that is, the vesting period). Refunds are recognised as an asset and income when the entity/employer becomes entitled to them (that is, by the employee failing to meet the vesting condition). The IFRS IC's agenda decision is only applicable in circumstances where employer contributions to a defined contribution plan have vesting conditions. It does not apply to defined benefit plans or to short-term and other long-term benefits. See further guidance related to benefit attribution for defined benefit plans (para 11.126) and other long-term benefits (para 11.40).

Disclosure

11.95 The only specific disclosure required by IAS 19 in respect of defined contribution plans is the amount recognised as an expense in the period. [IAS 19 para 53]. Pension plans are related parties and so contributions paid into defined contribution plans are transactions with related parties and should be disclosed as such. Additionally, disclosure of contributions paid and any balances outstanding in respect of key management personnel may also be required by IAS 24 (see chapter 29).

Defined benefit plans

Basic principles

11.96 Accounting for defined benefit plans is complex because actuarial assumptions and valuation methods are required to measure the balance sheet obligation and the income statement expense. The expense recognised does not necessarily equal the contributions made in the period. IAS 19's first objective is to ensure that an employer's financial statements reflect a liability when employees have provided services in exchange for benefits to be paid in the future. The standard describes how a defined benefit liability should be recognised and measured but, to the extent that this balance may be negative (that is, an asset), the same principles would apply. The plan liabilities (described by IAS 19 as the 'defined benefit obligation') and, in the case of a funded plan, the plan assets, are measured at each balance sheet date. The plan assets are measured at fair value. The defined benefit obligation is measured on an actuarial basis discounted to present value. The difference between the fair value of the plan assets and the present value of the defined benefit obligation is a surplus or deficit that, subject to certain conditions, should be recognised as an asset or liability on the employer's balance sheet.

11.97 A surplus is regarded as an asset to the extent that the employer can gain an economic benefit from it. A deficit is regarded as a liability to the extent that the employer has a legal or constructive obligation to make it good – this will nearly always be the case. In an unfunded plan, the employer has a direct obligation to pay the retirement benefits itself, so it recognises as a liability the gross amount of the plan liabilities. In a funded plan, plan assets are held in an entity (fund) that is legally separate from the reporting entity, so it recognises as an asset or liability the net surplus or deficit. The standard calls this net position the 'net defined benefit liability (asset)'. [IAS 19 para 8].

11.98 IAS 19 avoids implying that a surplus in a defined benefit pension plan is 'owned' by the employer. But conceptually an employer does not have to own a surplus in order to recognise an asset. It is sufficient that the employer has access to future economic benefits that it controls via, for example, the ability to reduce future employer contributions. Consequently, a surplus should be recognised as an asset to the extent that the employer is able to recover it through reduced future contributions or refunds, either directly to the employer or indirectly to another plan in deficit. [IAS 19 para 65]. Recoverability of a surplus is considered from paragraph 11.187.

11.99 The amount recognised as a net defined benefit liability (or asset, if negative) is the sum of the following amounts, adjusted for any effect of the asset ceiling:

- The present value of the defined benefit obligation at the reporting date (see from para 11.124).

Example 3 – Unused tax losses in an acquiree

Entity B has unrecognised deferred tax assets related to unused tax losses. Entity C bought entity B in December 20X3.

Entity C's management intends to integrate entity B's operations into entity C in the first quarter of 20X4 to take advantage of the tax losses. Entity C has a track record of generating taxable profits; and management expects this to continue for the foreseeable future.

In this situation, management should recognise a deferred tax asset in respect of the unused tax losses in the consolidated financial statements for the period ended 31 December 20X3 if it is probable that management will carry out the integration, and also that entity C will generate enough taxable profit to absorb entity B's unused tax losses. This will impact the goodwill calculation in the consolidated financial statements.

This contrasts with the situation in example 2, as both the newly acquired entity holding the losses (entity B) and the profitable entity (entity C) are part of the same group at the balance sheet date.

[The next paragraph is 13.144.]

Unused tax losses and unused tax credits**Trading losses**

13.144 Where an entity has tax losses that can be relieved against a tax liability for a previous year, those losses are recognised as an asset, because the tax relief is recoverable by refund of tax previously paid. [IAS 12 para 14]. This asset can be shown separately in the financial statements as a debtor, or it can be offset against an existing current tax balance.

13.145 Where tax losses can be relieved only by carry-forward against taxable profits of future periods, a deductible temporary difference arises. If an entity maintains a deferred tax account that will result in future tax payable, the tax losses will be recoverable by offset against taxable income that arises when those taxable temporary differences reverse. [IAS 12 para 36(a)]. So losses carried forward can be offset against deferred tax liabilities carried in the balance sheet, as discussed in paragraph 13.134.

13.146 Where the deferred tax liabilities are not sufficient to absorb all the tax losses, management should consider other convincing evidence suggesting that suitable taxable profits will be generated in future (see the example in para 13.134). This consideration becomes difficult, because the very existence of unrelieved tax losses is strong evidence that future taxable profit might not be available. Because of this significant uncertainty about future taxable profits being available, in the absence of profits arising from the reversals of existing temporary differences, the amount of the deferred tax asset and the nature of the evidence supporting its recognition should be disclosed (see para 13.306). [IAS 12 para 35].

13.147 The standard includes criteria that should be considered to determine whether a deferred tax asset in respect of unused tax losses or unused tax credits should be recognised. Some of these criteria are the same as for recognising deferred tax assets in respect of deductible temporary differences, such as the availability of sufficient taxable temporary differences and tax planning opportunities (discussed above).

13.148 For unrelieved trading losses resulting from identifiable causes, it is important to consider whether those losses are likely to recur. Where they are likely to recur, it is unlikely that a deferred tax asset can be recognised. Another criterion considered by the standard is the availability of taxable profits before unused tax losses or unused tax credits expire. [IAS 12 para 36(b)].

13.149 A strong earnings history may provide objective evidence of future profitability when assessing the extent to which a deferred tax asset can be recognised. This justification becomes stronger if the tax loss arises from identifiable causes that are unlikely to recur, as stated above.

13.150 For entities with no record of profit in recent years, a more rigorous assessment is required of the probability that taxable profit will be available against which unrelieved tax losses can be utilised. A history of recent losses creates a level of uncertainty about an entity's future profitability that could be difficult to rebut. If it is not probable that taxable profit will be available, the deferred tax asset is not recognised. [IAS 12 para 35]. See also paragraph 13.135.5 for start-up businesses.

13.150.1 For entities with only a limited record of profits in recent years, it might be difficult to place significant reliance on internal management projections. If the future taxable profits are nonetheless considered probable, the entity will need to develop projections on which to measure the recoverable deferred tax asset. The further into the future it is necessary to look for sufficient taxable profits, the more subjective the projections become. In the past, one approach has been to project income into the future using the average annual income for a past period. This approach would ultimately need to be reconciled with the requirement to assess the probable future taxable profits.

13.150.2 There should be no arbitrary cut-off in the time period over which an assessment of expected taxable profits is made (for example, the recoverability test should not be limited using an arbitrary look-out period solely because budget information is not available after a certain number of years). The assessment should be broadly consistent with the assumptions used for impairment testing (see further chapter 18), allowing for adjustments for the different time-frame (if the tax losses have expiry dates) and the different methods; these include discounting and the value in use model in IAS 36 as compared to a calculation with no discounting and including the impact of future asset improvements under IAS 12.

13.150.3 It could be argued that the probability of taxable profits decreases over time; so there could be a point when taxable profits are no longer probable.

address revenue recognition and does not, therefore, change the IAS 18 requirements. Also, IAS 37 does not specify whether expenditures are treated as expenses or assets when a provision is made. [IAS 37 paras 6, 8].

21.5 Some provisions meet the definition of a financial instrument. IAS 32 defines a financial instrument as “any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity”. [IAS 32 para 11]. IAS 37 states that it does not apply to provisions resulting from financial instruments that are within IAS 39’s scope. So, for example, IAS 37 would not apply to provisions in respect of derivative financial instruments that are required by IAS 39 to be carried at fair value.

21.6 Financial guarantee contracts are within the scope of IAS 39. But, if an issuer had, before the 2005 amendment to IAS 39, asserted explicitly that it regarded them as insurance contracts and had used accounting applicable to insurance contracts, the issuer could elect to apply either IAS 39 or IFRS 4 to such financial guarantee contracts. [IAS 39 para 2(e); IFRS 4 para 4(d)].

21.7 IAS 39 generally requires the issuer of a financial guarantee contract to measure the contract initially at fair value (likely to be the price paid for it in an arm’s length transaction). The guarantee would be measured subsequently (unless it is designated as at fair value through profit or loss, if permitted) at the higher of (i) the amount determined in accordance with IAS 37, and (ii) the amount initially recognised less, when appropriate, amortisation recognised in accordance with IAS 18. See further paragraph 21.266 onwards.

21.8 IFRS 7 also applies to provisions that meet IAS 39’s definition of a financial instrument (for example, an onerous provision for a vacant leasehold property that is being sub-let). IFRS 7 is discussed in more detail in chapter 6.

21.9 The list in paragraph 21.3 of exclusions from IAS 37’s scope refers to executory contracts. These are contracts under which neither party has performed any of its obligations, or both parties have partially performed their obligations to an equal extent. [IAS 37 para 3]. Executory contracts encompass commitments to purchase goods or to deliver services where performance has not yet happened. In some situations these types of contracts might be onerous and where they are, the requirements in IAS 37 concerning onerous contracts should be applied (see further para 21.161 onwards).

21.10 The word ‘provision’ is often used to describe amounts that are deducted from assets to arrive at their balance sheet carrying amount. For example, provisions are made for depreciation or amortisation or impairment of assets and provisions are made for bad and doubtful debts. These types of provisions do not fall within IAS 37’s scope, because they relate to the measurement of assets and are merely adjustments made to arrive at the asset’s appropriate carrying value. [IAS 37 para 7].

Provisions versus other liabilities

21.11 A provision is simply defined as “a liability of uncertain timing or amount”. [IAS 37 para 10]. So, for a provision to be necessary, an entity must have an obligation that is expected to result in an outflow of resources embodying economic benefits and that results from a past transaction or event.

21.12 Provisions differ from other liabilities in the degree of certainty about the amount of the payment or the timing of the payment. So, there is a clear distinction between provisions and other liabilities such as trade payables and accruals.

21.13 Trade and other payables form a separate line item in the balance sheet under IAS 1. [IAS 1 para 54(k)]. This item should only include liabilities to pay for goods or services that have been received or supplied and that have been invoiced or formally agreed with the supplier. [IAS 37 para 11(a)]. Amounts arising from a contract are formally agreed. So, for example, an operating lease obligation would be a trade payable.

21.14 Also, a distinction has to be made between accruals and provisions. Accruals are often reported as part of trade and other payables, whereas provisions are reported separately. [IAS 1 para 54(l)].

21.15 While there is little, if any, uncertainty relating to the amount of a trade payable or the timing of when it becomes due, there is some uncertainty with an accrual, which primarily arises because an invoice has not yet been received at the balance sheet date. But, typically a very good estimate can be made of the amount due at the period end, and the timing of the payment is often certain (to within a short period of time). So, accruals are a liability to pay for goods or services that have been supplied, but have not been paid, invoiced or formally agreed with the supplier. [IAS 37 para 11(b)].

21.16 A familiar example is the supply of electricity. At the period end the entity can make a very good estimate, or can measure the quantity, of electricity consumed within the business that has not been paid for or invoiced. Either by using current rates or previous bills, it can calculate the amount that is likely to be due. The amount of the liability is almost certain if the estimate is reliable and the timing of the payment is known to within a few days. Although an accrual is estimated and the timing of the payment is not known exactly, the degree of uncertainty is much less than that associated with a provision.

21.17 Rent should be classified as a financial liability, because the obligation arises under a contract and is formally agreed. Amounts due to employees relating to short-term holiday pay (which is covered by IAS 19) should be accounted for as an accrual. For example, an entity with a factory that closes for August would accrue, over the 12 months before the summer holiday, one month’s pay for each worker expected to receive holiday pay (so its 31 December financial statements would include an accrual of four months’ pay for each of those workers).

If the event is the regulator removing the silo's ring-fence protection (for example, a public interest right) and the regulator has never used, and is unlikely to use, these powers, the definition of a deemed entity might be satisfied. However, the reasons why the regulator requires the entity to hold 5% of total assets as regulatory capital should be understood, because these reasons may suggest a possible breach of the silo is substantive.

Example 5 – Breach in the event of fraud

Similar to example 4 above, a bank sets up a vehicle to fund the acquisition of mortgage loans from third-party asset sellers. The vehicle will be divided into a number of conduits, each holding a different pool of assets subject to unique risks. Each conduit will issue approximately CU 500 million of loan notes to investors to fund the acquisition of the mortgage loans. A significant portion of the acquired loans will be self-certified mortgage loans.

The note holders' claims are ring-fenced to the specific conduit's assets. However, due to concerns arising from misrepresentation of income levels, the bank will make available a CU 50 million pool of assets to cover losses suffered by a conduit where a borrower fraudulently obtained their loan.

The conduits will not be deemed separate entities, because the misrepresentation of income levels is a general business risk associated with self-certified mortgage loans. A breach of a silo due to fraud will be substantive where the purpose and design of the silo envisages the silo's ring-fencing being breached on a fraudulent event, in this case the misrepresentation by the borrower.

However, where the silo's ring-fence might be breached only in the event of a significant fraud committed by the bank setting up the conduits, the silos might be deemed separate entities. In such cases the entity would need to consider both the likelihood of fraud occurring and whether the silo's purpose and design has been structured to deal with fraud.

Link between power and variable returns – Principal and agent

24.124 IFRS 10 has introduced explicit guidance on how to assess whether a decision-maker is an agent (acting on behalf of others) or a principal (acting on its own behalf).

24.125 The entities that will be impacted by this new guidance will vary. In the asset management industry this might impact fund managers, asset management entities, unit trusts, partnerships or any kind of structure that involves two or more parties where one party has delegated power to direct the activities of an investee. Other industries where this guidance could have an impact include other financial services entities, construction, extractive and the real estate industries.

24.126 Common situations where the principal/agent guidance may be relevant are noted below:

- A fund manager establishes, markets, manages and invests in a fund that also has third party investors.

- A corporate delegates powers to another entity to manage a specific business activity, for example where an entity enters into an outsourcing arrangement.
- A servicer that collects and distributes cash flows, performs other administrative tasks and works out defaulted assets in a securitisation structure.

24.127 Power, returns and the ability to vary the returns need to be present to establish control. Most funds in the asset management industry will provide asset managers with wide ranging powers; often these powers will be set out in an investment mandate that was established when the fund was set up, perhaps by the fund manager itself. Such investment mandates detail the investment manager's powers and decision making authority over investments. Applying the control principles to asset managers is complex because, in addition to having power, they are generally exposed to variable returns from the funds they manage via their asset management fees even if they have no direct interest in them. The agency/principal guidance helps to distinguish whether a party is acting primarily for the other investors or whether it is acting primarily for its own benefit.

24.128 It should be noted that the guidance on delegated power mostly provides indicators of power and returns; in the main it does not provide bright lines on how much power or exposure to variable returns is required to indicate control. Significant judgment may be required.

Assessment of whether a decision maker is acting as principal or agent

24.129 A decision maker is "an entity with decision making rights that is either a principal or an agent for other parties". [IFRS 10 App A].

24.130 An agent is a party engaged to act on behalf of another party (the principal or principals). A principal may delegate some of its decision making authority over an investee to an agent; the agent does not control the investee when it exercises such powers on behalf of the principal. [IFRS 10 App B para B58]. The agent does not consolidate the investee as the necessary link between power and exposure to variable returns is not present. Conversely, a principal may control the relevant activities of an investee, which are carried out by the agent, and may be exposed to variable returns. Where this is the case, the principal is required to consolidate the investee as its subsidiary.

24.131 A decision maker will not necessarily be an agent because it has to act in the interests of other parties due to contractual or other legal reasons. In some circumstances the decision maker may receive a large proportion of the investee's variable returns as a result of the decisions it has made, in which case this may result in the decision maker being assessed as a principal rather than the an agent. [IFRS 10 BC 130]. The decision maker may be primarily acting for its own benefit.

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24.2 – Separate financial statements

Preface

24.2.1 This chapter deals with the requirements for the preparation of separate financial statements in accordance with IFRS. IAS 27 is the main accounting standard that deals with this subject. IAS 27 was reissued in 2011 concurrently with the issuance of IFRS 10. The reissued version is applicable for annual periods beginning on or after 1 January 2013. IAS 27 primarily focuses on the recognition and measurement of investments in subsidiaries, joint ventures and associates in separate financial statements. The standard also provides limited guidance on the presentation and preparation of separate financial statements.

Introduction

24.2.2 Separate financial statements should be prepared in accordance with all applicable IFRSs. [IAS 27 para 9]. This includes applying the provisions of IAS 1 in preparing and presenting general purpose financial statements in accordance with IFRSs, and the disclosure and measurement provisions from other IFRSs as applicable. [IAS 1 para 4]. Specific guidance for the recognition and measurement of investments in subsidiaries, joint ventures and associates is provided in IAS 27 (see further para 24.2.14). [IAS 27 para 10].

Objectives and scope

24.2.3 Separate financial statements are defined as those presented by:

- a parent (that is, an investor with control of a subsidiary); or
- an investor with joint control of an investee; or
- an investor with significant influence over an investee;

in which the investments are accounted for at cost or in accordance with IAS 39 (or IFRS 9 where this standard is applied). [IAS 27 para 4].

24.2.4 IAS 27 does not mandate which entities should produce separate financial statements. An entity might be required by local legislation or might elect to present separate financial statements. If separate financial statements are prepared, IAS 27 should be followed. [IAS 27 para 3].

Example 1 – Intangible asset that is separable only with another asset

Entity A acquired entity B. Entity B has a trademarked product and it has in-house, but not legally protected, expertise that is needed to produce the trademarked product. It can only sell the trademark along with the related unprotected expertise. Is the expertise recognised as an intangible asset in the business combination?

Yes. The unprotected expertise does not meet the contractual-legal criterion. However, because it can be separated from entity B and sold if the trademark is sold, it meets the separability criterion. [IFRS 3 App B para 34(b)].

Example 2 – Intangible asset that is separable only with another asset

Entity C acquired entity D. Entity D operates in a territory where deposit liabilities and the related depositor relationships are exchanged in observable transactions. Does entity C recognise the depositor relationships in the business combination?

Yes. The relationships can be sold together with the related deposits, and there is evidence of this separability through exchange transactions. [IFRS 3 App B para 34(a)].

Example 3 – Identifying intangible assets separately from goodwill

Entity E acquired entity F. Entity E is a media company with operations in telecommunications and entertainment. The goodwill following the initial purchase price allocation was larger than management had expected. A subsequent detailed analysis of the business valuations and due diligence reports identifies that the following items have been included in goodwill:

- Concession to operate a telecom network.
- Broadcasting licence.
- Highly skilled assembled workforce.
- Employment contracts for key employees with enforceable non-compete clauses.
- Talent contracts for star presenters.
- Advertising contracts.
- Contractual customer relationships.
- Programming rights for first exclusive re-run of two popular programmes.
- Databases containing customer information.

Should these items be recognised separately from goodwill?

There are a number of items currently incorrectly included in goodwill that management should recognise as separate intangible assets.

The concession to operate a telecom network and the broadcasting licence are protected by legal rights and are separable from the entity. Both meet the contractual-legal criterion. They are, therefore, recognised as intangible assets.

The assembled workforce remains subsumed in goodwill. It represents the value that allows the acquirer to operate the acquired business from the date it has been acquired and is not the intellectual capital of the workforce. It is not identifiable, being neither separable from the business nor contractual in nature. It is not, therefore, recognised separately from goodwill. [IFRS 3 App B para 37].

Non-compete clauses in employment contracts give rise to economic benefits as a result of legal rights and are recognised as intangible assets. The entity can control the benefits arising from employment through the provisions in the contracts, unlike the assembled workforce. These prevent employees from passing on valuable company information to a competitor for a time period after leaving. An intangible asset exists to the extent that an employment contract is beneficial compared to market terms. [IFRS 3 para IE37]. However, the recognition of employment contract intangible assets and liabilities is rare in practice. Contracts that are not beneficial compared to market terms do not represent assets because they are executory in nature. The acquiree will receive services equivalent to the cost of employment. See paragraph 25.286.1 for further discussion of non-compete agreements.

The future benefits arising from working with a number of star presenters employed by the acquired entity are protected by legal rights through talent contracts. These contracts are also separable from the acquired entity. They are recognised separately as intangible assets.

Benefits from advertising contracts and programming rights are protected by legal rights as well as being separable from the entity. They are recognised as separately identifiable intangible assets.

Customer information stored in databases will be used by the acquirer in future advertising campaigns. Benefits from the use of the databases are not protected by legal rights. Whether they are separable from the acquired entity depends on applicable data protection legislation. If legislation allows the acquirer to separate the information contained in the databases from the business and sell it to a third party, it will be recognised as a separately identifiable intangible asset. If not, it will be subsumed in goodwill.

25.110 The acquiree's in-process research and development is recognised by the acquirer separately from goodwill if it is identifiable.

Example – Recognising in-process research and development separately from goodwill

Entity G, a pharmaceutical group, acquires entity H, a rival pharmaceutical business. Entity H has incurred significant research costs in connection with two new drugs that have been undergoing clinical trials. One drug has not been given regulatory approval, although entity G expects that approval will be given within two years. The other drug has recently received regulatory approval. The drugs' revenue-earning potential was one of the principal reasons why entity G decided to acquire entity H. Are either of the drugs recognised as intangible assets?

Yes. Both drugs are separable: there is evidence of exchange transactions of early stage compounds and of late stage products. The fair value of rights to both drugs is recognised.

Distribution to owners must be highly probable

26.52.1 For a distribution to be highly probable, actions to complete the distribution should have been initiated and should be expected to be completed within one year from the date of classification. Actions required to complete the distribution should indicate that it is unlikely that significant changes to the distribution will be made or that the distribution will be withdrawn. The probability of shareholders' approval (if required in the jurisdiction) should be considered in the assessment of 'highly probable'. [IFRS 5 para 12A].

Newly acquired assets or disposal groups

26.53 If an asset or a disposal group (for example, a subsidiary that has been acquired as part of a business combination that management intend not to retain) is acquired with a view to resale then an entity is unlikely to be able, under the rules outlined above, to meet all the conditions for classification as held for sale on the date of acquisition; actively marketing the asset at the point of acquisition would be difficult. For this reason, IFRS 5 provides that in such circumstances an entity should still meet the one year condition (bullet point four of para 26.48 above) and it should be highly probable that the entity will meet all the other conditions to be classified as held for sale within a short period of the acquisition. The standard states that this 'short period' is usually within three months. [IFRS 5 para 11]. Newly acquired subsidiaries are dealt with from paragraph 26.146.

Extension of the one year period condition

26.54 In certain circumstances an entity can go beyond the one year condition. Classification as held for sale can generally only happen when the sale is expected to be completed within one year of the date of classification. However, the sale date may extend beyond one year from the date of classification as held for sale when a delay is caused by events outside the entity's control and there is evidence that the entity is still committed to the plan to sell the non-current asset or disposal group. [IFRS 5 para 9]. This is subject to the conditions described below.

26.55 There are three circumstances in which the standard allows for an extension of the one year period. In each case, a number of detailed conditions must be met if an asset or disposal group is to continue to be classified as held for sale when the one year condition is breached. These are set out in Appendix B to the standard and are detailed below:

- At the date the entity commits itself to a plan to sell the non-current asset or disposal group it has a reasonable expectation that other parties, that are not the buyer, will impose conditions that will extend the period required to complete the sale and:
 - actions required to meet those conditions cannot begin until a firm purchase commitment is obtained; and
 - a firm purchase commitment is highly probable within one year.

- The entity obtains a firm purchase commitment and the buyer or other parties unexpectedly impose conditions on the transfer of a non-current asset or disposal group that has been classified as held for sale that will extend the period required to complete the sale and:
 - the entity has taken timely actions to respond to the conditions; and
 - a favourable resolution of the factors delaying the sale is expected.

- During the one year period following classification as held for sale, circumstances occur that had previously been thought unlikely to happen and the asset or disposal group is not sold by the end of the year and:
 - during the initial one-year period after classification as held for sale the entity took the necessary action to respond to the change in circumstances;
 - the non-current asset or disposal group is being actively marketed at a reasonable price given the change in circumstances; and
 - the criteria in paragraphs 7 and 8 of IFRS 5 (described from para 26.43) continue to be met.

[IFRS 5 App B].

26.56 These conditions are discussed in more detail in the paragraphs that follow.

Events are expected to delay the sale at the date of initial classification

26.57 The first bullet point in paragraph 26.55 deals with the situation where it is known at the time of classification as held for sale that there are likely to be conditions that will extend the period until sale beyond one year. The cause of the extension beyond one year must be by someone who is neither the seller nor the expected buyer. If the cause is the seller's, the asset will not be classified as held for sale in the first place, because it is not available for sale in its present condition.

26.58 An example of a buyer-seller imposed condition that would fail the test is an agreement that a contract will be agreed at some time in the future (that is, an agreement is entered into to sell in two years time). The asset has not been sold within a year and it is correct that it is not classified as held for sale.

26.59 In addition to the conditions being imposed by someone who is not the buyer, the actions that are needed to respond to the conditions are unable to begin until after a firm purchase commitment is obtained. A firm purchase commitment is defined as:

"an agreement with an unrelated party, binding on both parties and usually legally enforceable, that (a) specifies all significant terms, including the price and timing of the transactions, and (b) includes a disincentive for non-

27.7 IFRS 10 provides a limited scope exception for parents that are 'investment entities'. Investment entities include venture capital organisations and mutual funds, unit trusts and similar entities. IFRS 10 exempts these investment entities from consolidating underlying investees that it controls; instead, parents are required to account for these subsidiaries at fair value through profit or loss under IFRS 9. [IFRS 10 para 31]. The investment entities amendments to IFRS 10 apply for annual periods beginning on or after 1 January 2014; earlier application is permitted. See chapter 24.1 for more information on the requirements of investment entities.

27.8 As stated in the previous paragraph, the IFRS 10 amendments will be effective for annual periods beginning on or after 1 January 2014. This means that paragraphs 27.9 to 27.12 are still applicable for 2013 year end financial statements.

'Venture capital' investments

27.9 A 'venture capital' investment can be distinguished from other investments by considering the way it is managed, the nature of the investment, and expected returns.

27.10 'Venture capital' investments are often in high-risk start-up ventures and the entity looks for capital growth, rather than an income return. The 'venture capital' investments are held as part of an investment portfolio where their value is through their marketable value rather than as a medium through which the entity carries out its business. The entity aims to generate a growth in the value of its investments in the medium term and usually identifies an exit strategy or strategies when the investment is made. The investments are typically in businesses unrelated to the entity's business. The investments are managed on a fair value basis.

27.11 In these circumstances, fair value information is considered by the industry as more relevant than equity accounting. [IAS 28 para BC12].

27.12 In contrast, an investment in a 'non-venture capital' associate is made for strategic purposes, rather than for medium term growth in fair value. An entity might make a strategic investment in a similar or related business to derive synergy or other benefits or as the first step towards acquisition. A strategic investment is held for the longer term and might generate benefits in addition to growth in the investment's fair value. Hence, such an investment would not be considered a 'venture capital' investment.

Venture capital 'organisation'

27.13 In many cases it may be obvious that an entity qualifies for the exemption if it principally only undertakes venture capital activities.

27.14 For example, where an entity is a member of a recognised venture capital organisation or meets the conditions for membership of a recognised venture capital organisation, this would be evidence that it met the conditions for exemption in IAS 28. Indicators that an entity is a venture capital organisation are:

- Have, as its principal business, the provision of equity finance to unquoted companies and make its returns mainly through medium to long-term capital gain. These activities may include start-up and other early stage, expansion, management buy-out or management buy-in investment which includes an 'equity-type' return.
- Take an active role in helping to build and develop the companies in which it invests.
- Be a member of a recognised regulatory authority where appropriate.

27.15 However, it may be less obvious where an entity undertakes both venture capital and other business activities.

27.16 The exemption applies to venture capital 'organisations'. The 'organisation' does not have to be a separate legal entity, but it does have to be a division or a branch clearly separated and managed independently from the entity's other business activities (for example, the division or branch may have its own management team). The 'organisation' must undertake a venture capital business that is managed with the objective of earning a return on its venture capital investments.

27.17 The exemption in IAS 28 applies if the venture capital organisation is a subsidiary included in the parent's consolidated financial statements, even if the parent itself is not a venture capital organisation. However, the scope exemption is not applied to investments in the same investee that are held by the parent's other subsidiaries or divisions that are not venture capital organisations. Indeed, it would also be necessary to consider whether the investment made by the subsidiary venture capital organisation in a related group entity is a venture capital investment and whether the parent (in its consolidated financial statements) and subsidiary (in its own financial statements) should equity account the investment instead.

27.18 The following example illustrates where the exemption would be available to an entity that has venture capital activities in addition to its main trading activities.

Example – Entity undertakes both venture capital and other business activities

An entity is interested in making investments in high growth/start-up companies. Some of the investments may well be over 20%. Some of the investments are likely to qualify as associates under IAS 28, but others will not. Management would like to hold the investments for the medium-term, but would seek to exit as soon as a flotation or sale occurred. The entity itself has an established business in the retail

Exemption from the preparation of consolidated financial statements

28.95 IFRS 10 exempts certain parents with investments in both subsidiaries and joint ventures from having to prepare consolidated financial statements and, therefore, from having to consolidate and equity account those subsidiaries and joint ventures. [IFRS 10 para 4(a)]. This is discussed further in chapter 24.

28.96 IAS 28 additionally specifies that venturers that only have investments in joint ventures do not need to apply equity accounting in their financial statements if all of the following conditions are met:

- “(a) The entity is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the entity not applying the equity method.*
- (b) The entity’s debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).*
- (c) The entity did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation, for the purpose of issuing any class of instruments in a public market.*
- (d) The ultimate or any intermediate parent of the entity produces consolidated financial statements available for public use that comply with IFRSs.”*

[IAS 28 para 17].

28.97 In respect of the last point above, IFRS ‘as endorsed by the EU’ and other GAAPs that are closely based on IFRS do not strictly fulfil the definition of IFRS. The exemption is available when the ultimate or intermediate parent that produces consolidated financial statements can make an explicit and unreserved statement of compliance with IFRS.

28.98 Local regulatory requirements might require entities to prepare consolidated financial statements and might also provide exemptions from producing consolidated financial statements under certain circumstances. Legislation or regulations that permit the entity not to produce consolidated financial statements under IFRS do not override the requirement in IAS 28. Separate entity financial statements that include an explicit and unreserved statement of compliance with IFRS should therefore be accompanied by a qualified or adverse opinion for the failure to present consolidated financial statements if consolidated financial statements are required by IFRS 10. Entities with separate financial statements that do not include the statement of compliance but state, for example, ‘IFRS as endorsed in the EU’, may take advantage of any relevant regulatory exemption that exempts them from preparing consolidated financial statements, without the need to qualify or give an adverse opinion.

Venture capital organisations

28.99 Venture capital organisations, mutual funds, unit trusts and similar entities that invest in a joint venture can designate these investments as at fair value through profit and loss upon initial recognition, in accordance with IAS 39 or IFRS 9. Consequently, they need not apply the equity method of accounting. [IAS 28 para 18].

28.100 Where only a portion of the joint venture is held via a venture capital organisation or similar entity, management can also apply the above exemption to that proportion of their investment, even if that holding is indirect. [IAS 28 para 19].

Classified as held for sale

28.101 The equity method of accounting is not applied to investments in joint ventures that are classified as held for sale in accordance with IFRS 5. [IAS 28 para 20]. The accounting and presentation requirements of IFRS 5 are applied from the date the venture qualifies as held for sale.

28.102 A joint venturer measures a joint venture that is classified as held for sale at the lower of its carrying amount and fair value less costs to sell. [IFRS 5 para 15]. The equity accounting therefore ends once a joint venture is classified as held for sale.

28.103 IAS 28 contains a ‘partial disposal’ concept. IFRS 5 is applied to a portion of a joint venture, if it meets the criteria of held for sale. This allows for only the ‘held for sale’ portion to be classified and accounted for under IFRS 5. The remaining portion of the investment continues to be accounted for under IAS 28. The classification of interests as held for sale and the relevant presentation and disclosure requirements are discussed in chapter 26.

28.104 Where a joint venture previously classified as held for sale no longer meets the conditions to be classified as held for sale, management should restate the previous year’s comparatives and account for the joint venture using the equity method from the date the joint venture was classified as held for sale. [IAS 28 para 21]. Financial statements for the periods since classification as held for sale should be amended; this will entail a prior-year adjustment.

[The next paragraph is 28.106.]

Net liability position of a joint venture

28.106 Where the joint venture is loss-making, the venturer only recognises its share of the loss until the carrying amount of its interest in the joint venture is reduced to zero. [IAS 28 para 39]. No further losses are recognised unless the venturer has incurred legal or constructive obligations or made payments on the

30.77 In general, the reconciliation of profit or loss to net cash flows from operating activities will disclose movements in inventory, debtors and creditors related to operating activities, other non-cash items (for example, depreciation, provisions, gain or loss on sale of assets, share of profits of associates, charges relating to share-based payment) and other items, such as interest and taxation, which are required to be shown separately. For the reconciliation to be properly carried out, it will be necessary to analyse the movements in opening and closing debtors and creditors in order to eliminate those movements that relate to items reported in financing or investing activities. For example, a company may purchase a fixed asset prior to the year end on credit. In this situation, the closing creditors balance would need to be adjusted to eliminate the amount owing for the fixed asset purchase before working out the balance sheet movements for operating creditors.

30.78 It follows that movements in working capital would not necessarily be the same as the difference between the opening and the closing balance sheet amounts. This is because the balance sheet movements in inventory, debtors, and creditors may be affected by such items as acquisitions and disposals of subsidiaries during the year (see para 30.114), exchange differences on working capital of foreign subsidiaries (see para 30.139) and other non-cash adjustments for opening and closing accruals for non-operating items.

30.79 A question arises as to whether the eliminated items within each balance sheet movement of working capital need to be reported separately so that the overall movement between the opening and closing balance sheet amounts is readily understandable. For example, a company could identify the total balance sheet movement in creditors and then separately itemise the operating element and the other movements. The standard is silent on this point and in practice, this is rarely done; only the operating movement is reported.

30.79.1 Some companies monitor working capital movements on 'controllable' items (such as trade debtors, creditors and inventory), separately from other less 'controllable' items (such as provisions) as this is a key performance measure for management. Such movements are often presented in a separate line entitled 'net working capital movement' in the cash flow reconciliation. As IAS 7 does not specifically define net working capital, we consider this to be an acceptable presentation provided that the classification of items between the net working capital category and other category is consistent year on year.

Cash flow from investing activities

30.80 IAS 7 defines investing activities as "the acquisition and disposal of long-term assets and other investments not included in cash equivalents". [IAS 7 para 6]. Cash flows from investing activities, therefore, generally include the cash effects of transactions relating to the acquisition and disposal of any long-term asset or current asset investment (other than those regarded as cash equivalents). This includes cash flows relating to the acquisition or disposal of equity interests in other entities (including obtaining or losing control of subsidiaries, and

investments in or disposals of associates and joint ventures) or business units. The disclosure of cash flows from investing activities provides users with information on the extent of expenditure that has been incurred in order to generate the future cash flows and profits of the business.

30.80.1 Only expenditures that result in a recognised asset in the balance sheet are eligible for classification as cash flows from investing activities. [IAS 7 para 16]. This impacts the classification of expenditure for matters such as exploration activities or internal research activities that have an investing nature but do not result in a recognised asset. Similarly, transaction costs in a business combination are expensed as incurred under IFRS 3 and are, therefore, classified within operating activities in the cash flow statement (see para 30.117.2).

30.80.2 Similarly, transaction costs in a business combination are expensed as incurred under IFRS 3 and are, therefore, classified within operating activities in the cash flow statement (see para 30.117.2).

30.80.3 Excise tax (sometimes referred to as sales tax or similar) paid on acquisition of property, plant and equipment, that is recoverable against output tax, generally does not qualify as cash flows from investing activities as this does not result in recognition of assets in the balance sheet. Therefore, in such cases excise tax should be presented net within operating cash flows. See further paragraph 30.99 onwards.

30.81 IAS 7 gives the following examples of cash flows expected to be classified as investing activities:

- Payments to acquire long-term assets (including property, plant and equipment, intangibles and payments relating to capitalised development costs and self-constructed property, plant and equipment).
- Receipts from sales of long-term assets.
- Payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes). See further paragraph 30.114 onwards for required disclosures in relation to obtaining control of subsidiaries.
- Receipts from the sale of equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes). See further paragraph 30.114 onwards for required disclosures in relation to losing control of subsidiaries.
- Advances and loans made to other parties (other than those made by a financial institution).
- Receipts from the repayment of advances and loans made to other parties (other than those received by a financial institution).

- The cumulative inflation rate over three years is approaching, or exceeds, 100%.

[IAS 29 para 3].

31.15 A cumulative three year inflation rate exceeding 100% is a strong indicator of hyper-inflation, but the qualitative factors should also be considered. The factors have to be carefully weighed because it is not desirable to move in and out of hyper-inflationary reporting within a short time-period. As noted in paragraph 31.12, reporting entities in the same country should start applying IAS 29 at the same time in order to achieve comparability. [IAS 29 para 4].

31.16 Other characteristics that are not mentioned in the standard but that can be useful in determining the presence of hyper-inflation include:

- Severe exchange controls to protect the local currency.
- Frequent central bank intervention in the currency.

31.17 It is useful (though not required by the standard) to disclose the three-year cumulative inflation at the balance sheet date for each period presented in the financial statements.

Presentation of IAS 29 information

Presentation in the functional currency of a hyper-inflationary economy

31.18 The information required by IAS 29 is presented as the main financial statements. Presentation of the information as a supplement to unrestated financial statements is not permitted. The standard discourages separate presentation of the financial statements before restatement. [IAS 29 para 7]. However, such separate presentation of unrestated financial statements is not prohibited.

31.19 The prior year comparatives are restated in terms of the measuring unit current at the end of the latest reporting period. If prior year financial statements have already been prepared to conform with IAS 29, the current year conversion factor is applied to the prior year financial statements. [IAS 29 para 34].

Presentation in a stable currency

31.20 When an entity whose functional currency is the currency of a hyper-inflationary economy presents financial statements in a stable currency, it should ensure that the financial statements have dealt with the impact of hyper-inflation before being translated into the stable currency for presentation purposes. [IAS 21 para 43]. See further paragraph 31.81 for when a subsidiary in a hyper-inflationary economy is required to report to its parent for group purposes in a stable currency.

31.21 Once the impact of hyper-inflation has been dealt with, the provisions of paragraphs 42(b) and 43 of IAS 21 are applied. The year-end exchange rate is used to translate the financial statements into the stable currency for all periods presented (that is, including comparatives), unless the entity presented financial statements in a stable currency in the previous year. Where this is the case, the comparative amounts should be those that were presented as current year amounts in the relevant prior year's financial statements (that is, they are not adjusted for subsequent changes in the price level or subsequent changes in exchange rates). [IAS 29 para 34].

31.22 When paragraph 42(b) of IAS 21 is applied, differences will arise each period between the closing equity of the previous year and the opening equity of the current year if they are presented in a stable currency. This is because the rate at which the hyper-inflationary currency depreciates against the stable currency rarely equals the rate of inflation. In our view, there is an accounting policy choice between recognising these differences directly in equity and recognising them in other comprehensive income as a translation adjustment.

31.23 Recognition directly in equity is akin to a change in accounting policy in accordance with IAS 8. Further, the requirement to translate all income and expenses at the year-end exchange rate leaves no scope for adjusting such translated amounts for these differences. [IAS 21 para 42(a)]. On the other hand, paragraph 109 of IAS 1 explains that changes recognised directly in equity comprise only transactions with owners in their capacity as such, as well as related transaction costs. The translation difference is not a transaction with owners and paragraph 7 of IAS 1 requires such differences to be recognised in other comprehensive income.

Example – Catch-up adjustment in the period when IAS 29 is first applied

In November 20X9, country A enters into hyper-inflation. A subsidiary is required to report its annual financial statements for the year ended 31 December 20X9 to its overseas parent in a stable currency. The comparative information is not restated as it has already been presented in the stable currency.

There is a difference in the shareholders' equity reconciliation between the comparative period-end at 31 December 20X8 and the opening balance sheet at 1 January 20X9 due to the adoption of IAS 29 in 20X9. This is because, when a stable currency is used, paragraph 42(b) of IAS 21 prohibits restating comparatives. We believe such a difference may be recognised directly in equity (opening retained earnings) as it is akin to a change in accounting policy in accordance with IAS 8.

It would also be acceptable to recognise the difference arising from the adoption of IAS 29 in other comprehensive income as a translation adjustment, as long as it is disclosed clearly.

31.24 Other than the difference arising from the adoption of hyper-inflation accounting, the ongoing application of retranslation to closing exchange rates under IAS 21 and hyper-inflation adjustments under IAS 29 will lead to a further

income statement in accordance with IAS 39 (or IFRS 9). [IFRIC 12 para 25]. The effective interest method uses a set of *estimated* future cash flows through the expected life of the financial instruments using all of the financial instrument's contractual terms, rather than *contractual* cash flows. However, in practice, actual cash flows rarely occur in line with expectation. In these circumstances, IAS 39 (or IFRS 9) requires an adjustment to the carrying amount of the financial asset to reflect actual cash and revised estimated cash flows whenever circumstances require the operator to revise its cash flow estimates. The adjustment is recognised as income or expense in the income statement (see chapter 6.7).

33.91 It should be noted that, under IAS 39, although an available-for-sale financial asset with fixed or determinable payments should be measured at fair value with changes in fair value recognised directly in other comprehensive income, the amortised cost must still be calculated using the effective interest method to determine interest income. This means that the interest income recognised in the income statement would be the same irrespective of whether the operator classifies the financial asset as a loan or receivable or as available-for-sale. The amount that would fall to be recognised in other comprehensive income is the difference between fair value and amortised cost at each balance sheet date. Normally, no recycling of any cumulative gain or loss recognised in other comprehensive income will be necessary since at the end of the concession period, the fair value of the financial asset will be the redemption amount, if any. This means that changes in fair value arising during the concession period would have netted down to nil. Where, in the unlikely event, the financial asset is classified on initial recognition as at fair value through profit or loss, all changes in fair value are recognised in the income statement.

33.92 All financial assets, except those classified as at fair value through profit or loss, should be reviewed for impairment at each balance sheet date in accordance with IAS 39. If there is objective evidence of impairment, the operator should measure and record the impairment loss in the reporting period. IAS 39 provides examples of factors that may, either individually or taken together, provide sufficient objective evidence that an impairment loss has been incurred on a financial asset or group of financial assets (see chapter 6.7).

33.92.1 As explained in paragraph 33.84.1, under IFRS 9 the available-for-sale classification of financial assets from IAS 39 is no longer available. Hence, financial assets under service concession arrangements are either held at fair value through profit or loss or at amortised cost. For assets held at fair value, the accounting will follow the guidance set out in paragraph 33.89. For assets held at amortised cost, the guidance as set out in paragraph 33.90 will apply in calculating the amortisation required under the effective interest method. Furthermore, the impairment principles as set out in IAS 39 for assets held at amortised cost continue to apply under IFRS 9.

Intangible asset

Initial recognition

33.93 Consistent with the recognition of a financial asset, where the operator is granted the right to charge users, an intangible asset is set up as the operator recognises revenue, being the fair value of the construction services provided during the construction phase. That is, the intangible asset is built up from day one and continues to build up until the construction activity ceases. The asset is recorded in accordance with IAS 38 at cost, that is at the fair value of the construction services provided. [IFRIC 12 para 26].

Subsequent measurement

33.94 After initial recognition, the operator may choose to measure the intangible asset at cost or fair value that is determined by reference to an active market. [IAS 38 para 75]. This option is not available to the operator because the licence to charge users will not be traded in an active market. Consequently, the intangible asset will be measured at cost less accumulated amortisation and impairment losses.

Amortisation

33.95 Service concession arrangements normally have a finite term, although the term may be fairly long. Therefore, the useful life of an intangible asset recognised in a service concession arrangement is the arrangement's term. The intangible asset will be amortised on a systematic basis over that life. The residual value of a finite life intangible asset should be assumed to be zero because, when the concession comes to an end or the contract is transferred to another party, the operator ceases to charge users and the licence expires, even though the infrastructure may have a significant residual value. Therefore, the depreciable amount will be equal to original cost from the operator's perspective.

33.96 Amortisation should commence when the asset is available for use, that is, at the point in time when the operator exercises its rights under the licence to charge users. This may be a period of time after the construction asset is actually brought into use. For example, in some concession arrangements that give rise to a financial asset as well as an intangible asset, the arrangement's terms may give the operator an unconditional right to receive cash from the grantor during the concession's early years before the operator can charge users for the service. In that situation, it would be appropriate for the operator to delay amortisation until such time as it begins to charge users. However, until then the intangible asset should be reviewed for impairment at each reporting date (see para 33.95 below).

33.97 A variety of amortisation methods is allowed under IAS 38. These methods include the straight-line method, the diminishing balance method and the units of production method. [IFRIC 12 para BC64]. However, the 'interest' method of amortisation that takes into account the time value of money is not