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INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS

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Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 32, *Financial Instruments: Presentation* and International Financial Reporting Interpretations Committee Interpretation 2 (IFRIC 2), *Members' Shares in Co-operative Entities and Similar Instruments* published by the International Accounting Standards Board (IASB). Extracts from IAS 32 and IFRIC 2 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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IPSAS 28—FINANCIAL INSTRUMENTS:PRESENTATION

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 28, *Financial Instruments: Presentation* was issued in January 2010.

Since then, IPSAS 28 has been amended by the following IPSASs:

- IPSAS 43, *Leases* (issued January 2022)
- *COVID-19: Deferral of Effective Dates* (issued November 2020)
- IPSAS 42, *Social Benefits* (issued January 2019)
- IPSAS 41, *Financial Instruments* (issued August 2018)
- IPSAS 39, *Employee Benefits* (issued July 2016)
- *The Applicability of IPSASs* (issued April 2016)
- IPSAS 37, *Joint Arrangements* (issued January 2015)
- IPSAS 35, *Consolidated Financial Statements* (issued January 2015)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2014* (issued January 2015)
- *Improvements to IPSASs 2011* (issued October 2011)

Table of Amended Paragraphs in IPSAS 28

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
2	Amended	IPSAS 41 August 2018
3	Amended	IPSAS 35 January 2015 IPSAS 37 January 2015 IPSAS 39 July 2016 IPSAS 41 August 2018
4	Amended	IPSAS 41 August 2018
7	Deleted	The Applicability of IPSASs April 2016
8	Deleted	The Applicability of IPSASs April 2016
9	Amended	IPSAS 41 August 2018
10	Amended	IPSAS 41 August 2018
14	Amended	IPSAS 41 August 2018
28	Amended	IPSAS 41 August 2018
36	Amended	IPSAS 41 August 2018
40	Amended	Improvements to IPSASs January 2015
40A	New	Improvements to IPSASs January 2015
42	Amended	Improvements to IPSASs January 2015

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44	Amended	Improvements to IPSASs January 2015
47	Amended	IPSAS 41 August 2018
48	Amended	IPSAS 41 August 2018
56	Deleted	IPSAS 33 January 2015
57	Deleted	IPSAS 33 January 2015
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60A	New	Improvements to IPSASs January 2015
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60G	New	IPSAS 42 January 2019
60H	New	IPSAS 43 January 2022
61	Amended	IPSAS 33 January 2015
AG2	Amended	IPSAS 41 August 2018
AG16	Amended	IPSAS 43 January 2022
AG17	Amended	IPSAS 43 January 2022
AG23	Amended	IPSAS 42 January 2019
AG53	Amended	IPSAS 35 January 2015
AG55	Amended	IPSAS 41 August 2018
AG63	Deleted	IPSAS 41 August 2018
Heading above paragraph AG63A	New	IPSAS 41 August 2018
AG63A	New	IPSAS 41 August 2018
AG63B	New	IPSAS 41 August 2018
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AG63F	New	IPSAS 41 August 2018
B19	Amended	IPSAS 41 August 2018
B21	Amended	IPSAS 41 August 2018
IE1	Amended	IPSAS 41 August 2018
IE5	Amended	IPSAS 41 August 2018

IPSAS 28—FINANCIAL INSTRUMENTS: PRESENTATION

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International Public Sector Accounting Standard 28, *Financial Instruments: Presentation*, is set out in paragraphs 1–62. All the paragraphs have equal authority. IPSAS 28 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to establish principles for presenting financial instruments as liabilities or net assets/equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends or similar distributions, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.

2. The principles in this Standard complement the principles for recognizing and measuring financial assets and financial liabilities in IPSAS 41, *Financial Instruments*, and for disclosing information about them in IPSAS 30, *Financial Instruments: Disclosures*.

Scope (see also paragraphs AG3–AG9)

3. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard to all types of financial instruments except:**

   (a) **Those interests in controlled entities, associates or joint ventures that are accounted for in accordance with IPSAS 35, *Consolidated Financial Statements*, IPSAS 34, *Separate Financial Statements*, IPSAS 36, *Investments in Associates and Joint Ventures*. However, in some cases, IPSAS 34, IPSAS 35, or IPSAS 36 require or permits an entity to account for an interest in a controlled entity, associate, or joint venture using IPSAS 41; in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in controlled entities, associates, or joint ventures.**

   (b) **Employers' rights and obligations under employee benefit plans, to which IPSAS 39, *Employee Benefits* applies.**

   (c) **Obligations arising from insurance contracts. However, this Standard applies to:**

      (i) **Derivatives that are embedded in insurance contracts if IPSAS 41 requires the entity to account for them separately; and**

      (ii) **Financial guarantee contracts, if the issuer applies IPSAS 41 in recognizing and measuring the contracts, but shall apply the relevant international or national accounting standard dealing with insurance contracts if the issuer elects to apply that standard in recognizing and measuring them.**

   In addition to (i) and (ii) above, an entity may apply this Standard to insurance contracts which involve the transfer of financial risk.

   (d) **Financial instruments that are within the scope of the international or national accounting standard dealing with insurance contracts because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 13–37 and AG49–AG60 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this Standard applies to derivatives that are embedded in these instruments (see IPSAS 41).**

   (e) **Financial instruments, contracts and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share-based payments applies, except for:**

      (i) **Contracts within the scope of paragraphs 4–6 of this Standard, to which this Standard applies; or**

      (ii) **Paragraphs 38 and 39 of this Standard, which shall be applied to treasury shares purchased, sold, issued, or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.**

4. **This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements. However, this Standard shall be applied to those contracts that an entity designates as measured at fair value through surplus or deficit in accordance with paragraph 6 of IPSAS 41.**

5. There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:

   (a) When the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;

   (b) When the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument, or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);

   (c) When, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and

   (d) When the non-financial item that is the subject of the contract is readily convertible to cash.

   A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale, or usage requirements, and, accordingly, is within the scope of this Standard. Other contracts to which paragraph 4 applies are evaluated to determine whether they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale, or usage requirement, and accordingly, whether they are within the scope of this Standard.

6. A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 5(a) or (d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale, or usage requirements.

7. [Deleted]

8. [Deleted]

Definitions (see also paragraphs AG10–AG48)

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

   An <u>equity instrument</u> is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

   A <u>financial instrument</u> is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.

   A <u>financial asset</u> is any asset that is:

   (a) **Cash;**

   (b) **An equity instrument of another entity;**

   (c) **A contractual right:**

      (i) **To receive cash or another financial asset from another entity; or**

      (ii) **To exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity; or**

   (d) **A contract that will or may be settled in the entity's own equity instruments and is:**

      (i) **A non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or**

      (ii) **A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are**

classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

A financial liability is any liability that is:

(a) **A contractual obligation:**

(i) **To deliver cash or another financial asset to another entity; or**

(ii) **To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity; or**

(b) **A contract that will or may be settled in the entity's own equity instruments and is:**

(i) **A non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or**

(ii) **A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also, for these purposes the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.**

As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 15 and 16 or paragraphs 17 and 18.

10. The following terms are defined in paragraph 9 of IPSAS 41 or paragraph 10 of IPSAS 29, *Financial Instruments: Recognition and Measurement*, and are used in this Standard with the meaning specified in those Standard.

- Amortized cost of a financial asset or financial liability;
- Derecognition;
- Derivative;
- Effective interest method;
- Financial liability at fair value through surplus or deficit;
- Financial guarantee contract;
- Firm commitment;
- Forecast transaction;
- Hedge effectiveness;
- Hedged item;
- Hedging instrument;
- Held for trading;
- Regular way purchase or sale; and
- Transaction costs.

11. In this Standard, "contract" and "contractual" refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.

12. In this Standard, "entity" includes public sector entities, individuals, partnerships, incorporated bodies and trusts.

Presentation

Liabilities and Net Assets/Equity (see also paragraphs AG49–AG54)

13. **The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.**

14. When an issuer applies the definitions in paragraph 9 to determine whether a financial instrument is an equity instrument rather than a financial liability, the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.

    (a) The instrument includes no contractual obligation:

        (i) To deliver cash or another financial asset to another entity; or

        (ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the issuer.

    (b) If the instrument will or may be settled in the issuer's own equity instruments, it is:

        (i) A non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or

        (ii) A derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also, for these purposes the issuer's own equity instruments do not include instruments that have all the features and meet the conditions described in paragraphs 15 and 16 or paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the issuer's own equity instruments.

A contractual obligation, including one arising from a derivative financial instrument, that will or may result in the future receipt or delivery of the issuer's own equity instruments, but does not meet conditions (a) and (b) above, is not an equity instrument. As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraph 15 and 16 or paragraphs 17 and 18.

Puttable Instruments

15. A puttable financial instrument includes a contractual obligation for the issuer to repurchase or redeem that instrument for cash or another financial asset on exercise of the put. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all of the following features:

    (a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:

        (i) Dividing the entity's net assets on liquidation into units of equal amount; and

        (ii) Multiplying that amount by the number of the units held by the financial instrument holder.

    (b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:

        (i) Has no priority over other claims to the assets of the entity on liquidation; and

        (ii) Does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.

    (c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features. For example, they must all be puttable, and the formula or other method used to calculate the repurchase or redemption price is the same for all instruments in that class.

    (d) Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments as set out in subparagraph (b) of the definition of a financial liability.

(e) The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the surplus or deficit, the change in the recognized net assets or the change in the fair value of the recognized and unrecognized net assets of the entity over the life of the instrument (excluding any effects of the instrument).

16. For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:

(a) Total cash flows based substantially on the surplus or deficit, the change in the recognized net assets, or the change in the fair value of the recognized and unrecognized net assets of the entity (excluding any effects of such instrument or contract); and

(b) The effect of substantially restricting or fixing the residual return to the puttable instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 15 that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the puttable instrument as an equity instrument.

Instruments, or Components of Instruments, that Impose on the Entity an Obligation to Deliver to Another Party a pro rata Share of the Net Assets of the Entity only on Liquidation

17. Some financial instruments include a contractual obligation for the issuing entity to deliver to another entity a pro rata share of its net assets only on liquidation. The obligation arises because liquidation either is certain to occur and outside the control of the entity (e.g., a limited life entity) or is uncertain to occur but is at the option of the instrument holder. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all of the following features:

(a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:

(i) Dividing the net assets of the entity on liquidation into units of equal amount; and

(ii) Multiplying that amount by the number of the units held by the financial instrument holder.

(b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:

(i) Has no priority over other claims to the assets of the entity on liquidation; and

(ii) Does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.

(c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments must have an identical contractual obligation for the issuing entity to deliver a pro rata share of its net assets on liquidation.

18. For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:

(a) Total cash flows based substantially on the surplus or deficit, the change in the recognized net assets or the change in the fair value of the recognized and unrecognized net assets of the entity (excluding any effects of such instrument or contract); and

(b) The effect of substantially restricting or fixing the residual return to the instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 17 that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the instrument as an equity instrument.

Reclassification of Puttable Instruments and Instruments that Impose on the Entity an Obligation to Deliver to Another Party a pro rata Share of the Net Assets of the Entity only on Liquidation

19. An entity shall classify a financial instrument as an equity instrument in accordance with paragraphs 15 and 16 or paragraphs 17 and 18 from the date when the instrument has all the features and meets the conditions set out in those paragraphs. An entity shall reclassify a financial instrument from the date when the instrument ceases to have all the features or meet all the conditions set out in those paragraphs. For example, if an entity redeems all its issued non-puttable instruments and any puttable instruments that remain outstanding have all of the features and meet all the conditions in paragraphs 15 and 16, the entity shall reclassify the puttable instruments as equity instruments from the date when it redeems the non-puttable instruments.

20. An entity shall account as follows for the reclassification of an instrument in accordance with paragraph 19:

    (a) It shall reclassify an equity instrument as a financial liability from the date when the instrument ceases to have all of the features or meet the conditions in paragraphs 15 and 16 or paragraphs 17 and 18. The financial liability shall be measured at the instrument's fair value at the date of reclassification. The entity shall recognize in net assets/equity any difference between the carrying value of the equity instrument and the fair value of the financial liability at the date of reclassification.

    (b) It shall reclassify a financial liability as an equity instrument from the date when the instrument has all of the features and meets the conditions set out in paragraphs 15 and 16 or paragraphs 17 and 18. An equity instrument shall be measured at the carrying value of the financial liability at the date of reclassification.

No Contractual Obligation to Deliver Cash or Another Financial Asset (paragraph 14(a))

21. With the exception of the circumstances described in paragraphs 15 and 16 or paragraphs 17 and 18, a critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder) or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavorable to the issuer. Although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends or similar distributions declared, or distributions of the net assets/equity, the issuer does not have a contractual obligation to make such distributions because it cannot be required to deliver cash or another financial asset to another party.

22. The substance of a financial instrument, rather than its legal form, governs its classification on the entity's statement of financial position. Substance and legal form are commonly consistent, but not always. Some financial instruments take the legal form of equity instruments but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities. For example:

    (a) A preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability.

    (b) A financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset (a "puttable instrument") is a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. The financial instrument is a financial liability even when the amount of cash or other financial assets is determined on the basis of an index or other item that has the potential to increase or decrease. The existence of an option for the holder to put the instrument back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. For example, open-ended mutual funds, unit trusts, partnerships and some co-operative entities may provide their unitholders or members with a right to redeem their interests in the issuer at any time for cash, which results in the unitholders' or members' interests being classified as financial liabilities, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. However, classification as a financial liability does not preclude the use of descriptors such as "net asset value attributable to unitholders" and "change in net asset value attributable to unitholders" on the face of the financial statements of an entity that has no contributed net assets/equity (such as some mutual funds and unit trusts, see Illustrative Example 7) or the use of additional disclosure to show that total members' interests comprise items such as reserves that meet the definition of net assets/equity and puttable instruments that do not (see Illustrative Example 8).

23. If an entity 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 financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. For example:

(a) A restriction on the ability of an entity to satisfy a contractual obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the entity's contractual obligation or the holder's contractual right under the instrument.

(b) A contractual obligation that is conditional on a counterparty exercising its right to redeem is a financial liability because the entity does not have the unconditional right to avoid delivering cash or another financial asset.

24. A financial instrument that does not explicitly establish a contractual obligation to deliver cash or another financial asset may establish an obligation indirectly through its terms and conditions. For example:

(a) A financial instrument may contain a non-financial obligation that must be settled if, and only if, the entity fails to make distributions or to redeem the instrument. If the entity can avoid a transfer of cash or another financial asset only by settling the non-financial obligation, the financial instrument is a financial liability.

(b) A financial instrument is a financial liability if it provides that on settlement the entity will deliver either:

(i) Cash or another financial asset; or

(ii) Its own shares whose value is determined to exceed substantially the value of the cash or other financial asset.

Although the entity does not have an explicit contractual obligation to deliver cash or another financial asset, the value of the share settlement alternative is such that the entity will settle in cash. In any event, the holder has in substance been guaranteed receipt of an amount that is at least equal to the cash settlement option (see paragraph 25).

Settlement in the Entity's Own Equity Instruments (paragraph 14(b))

25. A contract is not an equity instrument solely because it may result in the receipt or delivery of the entity's own equity instruments. An entity may have a contractual right or obligation to receive or deliver a number of its own shares or other equity instruments that varies so that the fair value of the entity's own equity instruments to be received or delivered equals the amount of the contractual right or obligation. Such a contractual right or obligation may be for a fixed amount or an amount that fluctuates in part or in full in response to changes in a variable other than the market price of the entity's own equity instruments (e.g., an interest rate, a commodity price, or a financial instrument price). Two examples are (a) a contract to deliver as many of the entity's own equity instruments as are equal in value to CU100, and (b) a contract to deliver as many of the entity's own equity instruments as are equal in value to the value of 100 barrels of oil. Such a contract is a financial liability of the entity even though the entity must or can settle it by delivering its own equity instruments. It is not an equity instrument because the entity uses a variable number of its own equity instruments as a means to settle the contract. Accordingly, the contract does not evidence a residual interest in the entity's assets after deducting all of its liabilities.

26. Except as stated in paragraph 27, a contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument. For example, an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed price or for a fixed stated principal amount of a bond is an equity instrument. Changes in the fair value of a contract arising from variations in market interest rates that do not affect the amount of cash or other financial assets to be paid or received, or the number of equity instruments to be received or delivered, on settlement of the contract do not preclude the contract from being an equity instrument. Any consideration received (such as the premium received for a written option or warrant on the entity's own shares) is added directly to net assets/equity. Any consideration paid (such as the premium paid for a purchased option) is deducted directly from net assets/equity. Changes in the fair value of an equity instrument are not recognized in the financial statements.

27. If the entity's own equity instruments to be received, or delivered, by the entity upon settlement of a contract are puttable financial instruments with all of the features and meeting the conditions described in paragraphs 15 and 16, or instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation with all of the features and meeting the conditions described in paragraphs 17 and 18, the contract is a financial asset or a financial liability. This includes a contract that will be settled by the entity receiving or delivering a fixed number of such instruments in exchange for a fixed amount of cash or another financial asset.

28. With the exception of the circumstances described in paragraphs 15 and 16 or paragraphs 17 and 18, a contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (e.g., for the present value of the forward repurchase price, option exercise price, or other redemption amount). This is the case even if the contract itself is an equity instrument. One example is an entity's obligation under a forward contract to purchase its own equity instruments for cash. The financial liability is recognized initially at the present value of the redemption amount, and is reclassified from net assets/

equity. Subsequently, the financial liability is measured in accordance with IPSAS 41. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to net assets/equity. An entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising a right to redeem (e.g., a written put option that gives the counterparty the right to sell an entity's own equity instruments to the entity for a fixed price).

29. A contract that will be settled by the entity delivering or receiving a fixed number of its own equity instruments in exchange for a variable amount of cash or another financial asset is a financial asset or financial liability. An example is a contract for the entity to deliver 100 of its own equity instruments in return for an amount of cash calculated to equal the value of 100 barrels of oil.

Contingent Settlement Provisions

30. A financial instrument may require the entity to deliver cash or another financial asset, or otherwise to settle it in such a way that it would be a financial liability, in the event of the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances) that are beyond the control of both the issuer and the holder of the instrument, such as a change in a stock market index, consumer price index, interest rate, or taxation requirements, or the issuer's future revenues, surplus or deficit, or debt-to-equity ratio. The issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability). Therefore, it is a financial liability of the issuer unless:

(a) The part of the contingent settlement provision that could require settlement in cash or another financial asset (or otherwise in such a way that it would be a financial liability) is not genuine;

(b) The issuer can be required to settle the obligation in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) only in the event of liquidation of the issuer; or

(c) The instrument has all of the features and meets the conditions in paragraphs 15 and 16.

Settlement Options

31. **When a derivative financial instrument gives one party a choice over how it is settled (e.g., the issuer or the holder can choose settlement net in cash or by exchanging shares for cash), it is a financial asset or a financial liability unless all of the settlement alternatives would result in it being an equity instrument.**

32. An example of a derivative financial instrument with a settlement option that is a financial liability is a share option that the issuer can decide to settle net in cash or by exchanging its own shares for cash. Similarly, some contracts to buy or sell a non-financial item in exchange for the entity's own equity instruments are within the scope of this Standard because they can be settled either by delivery of the non-financial item or net in cash or another financial instrument (see paragraphs 4–6). Such contracts are financial assets or financial liabilities and not equity instruments.

Compound Financial Instruments (see also paragraphs AG55–AG60 and Illustrative Examples 9–12)

33. **The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability component and a net assets/equity component. Such components shall be classified separately as financial liabilities, financial assets, or equity instruments in accordance with paragraph 13.**

34. An entity recognizes separately the components of a financial instrument that (a) creates a financial liability of the entity and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the entity. For example, a bond or similar instrument convertible by the holder into a fixed number of ordinary shares of the entity is a compound financial instrument. From the perspective of the entity, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or another financial asset) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the entity). The economic effect of issuing such an instrument is substantially the same as issuing simultaneously a debt instrument with an early settlement provision and warrants to purchase ordinary shares, or issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the entity presents the liability and net assets/equity components separately in its statement of financial position.

35. Classification of a convertible instrument into its components is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders. Holders may not always act in the way that might be expected because, for example, the tax consequences resulting from conversion may differ among holders. Furthermore, the likelihood of conversion will change

from time to time. The entity's contractual obligation to make future payments remains outstanding until it is extinguished through conversion, maturity of the instrument, or some other transaction.

36. IPSAS 41 deals with the measurement of financial assets and financial liabilities. Equity instruments evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated into its components, the net assets/equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. The value of any derivative features (such as a call option) embedded in the compound financial instrument is included in the liability component unless it forms part of the component of net assets/equity (such as an equity conversion option). The sum of the carrying amounts assigned to the liability and the net assets/equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognizing the components of the instrument separately.

37. Under the approach described in paragraph 36, the issuer of a bond convertible into ordinary shares first determines the carrying amount of the liability component by measuring the fair value of a similar liability (including any embedded non-equity derivative features) that does not have an associated net assets/equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into ordinary shares is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole.

Treasury Shares (see also paragraph AG61)

38. **If an entity reacquires its own equity instruments, those instruments ("treasury shares") shall be deducted from net assets/equity. No gain or loss shall be recognized in surplus or deficit on the purchase, sale, issue, or cancellation of an entity's own equity instruments. Such treasury shares may be acquired and held by the entity or by other members of the economic entity. Consideration paid or received shall be recognized directly in net assets/equity.**

39. The amount of treasury shares held is disclosed separately either in the statement of financial position or in the notes, in accordance with IPSAS 1. An entity provides disclosure in accordance with IPSAS 20, *Related Party Disclosures* if the entity reacquires its own equity instruments from related parties.

Interest, Dividends or Similar Distributions, Losses, and Gains (see also paragraph AG62)

40. **Interest, dividends or similar distributions, losses, and gains relating to a financial instrument or a component that is a financial liability shall be recognized as revenue or expense in surplus or deficit. Distributions to holders of an equity instrument shall be recognized by the entity directly in net assets/equity. Transaction costs incurred on transactions in net assets/equity shall be accounted for as a deduction from net assets/equity.**

40A. Income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction shall be accounted for in accordance with the relevant international or national accounting standard dealing with income taxes.

41. The classification of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends or similar distributions, losses, and gains relating to that instrument are recognized as revenue or expense in surplus or deficit. Thus, dividends or similar distributions on shares wholly recognized as liabilities are recognized as expenses in the same way as interest on a bond. Similarly, gains and losses associated with redemptions or refinancings of financial liabilities are recognized in surplus or deficit, whereas redemptions or refinancings of equity instruments are recognized as changes in net assets/equity. Changes in the fair value of an equity instrument are not recognized in the financial statements.

42. An entity typically incurs various costs in issuing or acquiring its own equity instruments. Those costs might include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs, and stamp duties. Any related transaction costs are accounted for as a deduction from net assets/equity to the extent they are incremental costs directly attributable to the transaction that otherwise would have been avoided. The costs of such a transaction that is abandoned are recognized as an expense.

43. Transaction costs that relate to the issue of a compound financial instrument are allocated to the liability and the net assets/equity components of the instrument in proportion to the allocation of proceeds. Transaction costs that relate jointly to more than one transaction are allocated to those transactions using a basis of allocation that is rational and consistent with similar transactions.

44. The amount of transaction costs accounted for as a deduction from net assets/equity in the period is disclosed separately in accordance with IPSAS 1.

45. Dividends or similar distributions classified as an expense are presented in the statement of financial performance either with interest on other liabilities or as a separate item. In addition to the requirements of this Standard, disclosure of interest and dividends or similar distributions is subject to the requirements of IPSAS 1 and IPSAS 30. In some circumstances, because of the differences between interest and dividends or similar distributions with respect to matters such as tax deductibility, it is desirable to disclose them separately in the statement financial performance.

46. Gains and losses related to changes in the carrying amount of a financial liability are recognized as revenue or expense in surplus or deficit even when they relate to an instrument that includes a right to the residual interest in the assets of the entity in exchange for cash or another financial asset (see paragraph 22(b)). Under IPSAS 1 the entity presents any gain or loss arising from remeasurement of such an instrument separately in the statement of financial performance when it is relevant in explaining the entity's performance.

Offsetting a Financial Asset and a Financial Liability (see also paragraphs AG63 and AG64)

47. **A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:**

    (a) **Currently has a legally enforceable right to set off the recognized amounts; and**

    (b) **Intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.**

    In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability (see IPSAS 41, paragraph 33).

48. This Standard requires the presentation of financial assets and financial liabilities on a net basis when doing so reflects an entity's expected future cash flows from settling two or more separate financial instruments. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity. An entity shall disclose the information required in paragraphs 17B–17E in IPSAS 30 for recognized financial instruments that are within the scope of paragraph 17A of IPSAS 30.

49. Offsetting a recognized financial asset and a recognized financial liability and presenting the net amount differs from the derecognition of a financial asset or a financial liability. Although offsetting does not give rise to recognition of a gain or loss, the derecognition of a financial instrument not only results in the removal of the previously recognized item from the statement of financial position but also may result in recognition of a gain or loss.

50. A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement between the three parties that clearly establishes the debtor's right of set-off. Because the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and the laws applicable to the relationships between the parties need to be considered.

51. The existence of an enforceable right to set-off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability and may affect an entity's exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity's future cash flows are not affected. When an entity intends to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed. An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting because the rights and obligations associated with the individual financial asset and financial liability remain unaltered.

52. An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal operating practices, the requirements of the financial markets, and other circumstances that may limit the ability to settle net or to settle simultaneously. When an entity has a right of set-off, but does not intend to settle net or to realize the asset and settle the liability simultaneously, the effect of the right on the entity's credit risk exposure is disclosed in accordance with paragraph 42 of IPSAS 30.

53. Simultaneous settlement of two financial instruments may occur through, for example, the operation of a clearing house in an organized financial market or a face-to-face exchange. In these circumstances the cash flows are, in effect, equivalent to a single net amount and there is no exposure to credit or liquidity risk. In other circumstances, an entity may settle two

instruments by receiving and paying separate amounts, becoming exposed to credit risk for the full amount of the asset or liquidity risk for the full amount of the liability. Such risk exposures may be significant even though relatively brief. Accordingly, realization of a financial asset and settlement of a financial liability are treated as simultaneous only when the transactions occur at the same moment.

54. The conditions set out in paragraph 47 are generally not satisfied and offsetting is usually inappropriate when:

(a) Several different financial instruments are used to emulate the features of a single financial instrument (a "synthetic instrument");

(b) Financial assets and financial liabilities arise from financial instruments having the same primary risk exposure (e.g., assets and liabilities within a portfolio of forward contracts or other derivative instruments) but involve different counterparties;

(c) Financial or other assets are pledged as collateral for non-recourse financial liabilities;

(d) Financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation (e.g., a sinking fund arrangement); or

(e) Obligations incurred as a result of events giving rise to losses are expected to be recovered from a third party by virtue of a claim made under an insurance contract.

55. An entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a "master netting arrangement" with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract. These arrangements may be commonly used to provide protection against loss in the event of bankruptcy or other circumstances that result in a counterparty being unable to meet its obligations. A master netting arrangement commonly creates a right of set-off that becomes enforceable and affects the realization or settlement of individual financial assets and financial liabilities only following a specified event of default or in other circumstances not expected to arise in the normal course of operations. A master netting arrangement does not provide a basis for offsetting unless both of the criteria in paragraph 47 are satisfied. When financial assets and financial liabilities subject to a master netting arrangement are not offset, the effect of the arrangement on an entity's exposure to credit risk is disclosed in accordance with paragraph 42 of IPSAS 30.

Transition

56. [Deleted]

57. [Deleted]

58. [Deleted]

Effective Date

59. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2013. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2013, it shall disclose that fact.**

60. **An entity shall not apply this Standard before January 1, 2013, unless it also applies IPSAS 29 and IPSAS 30.**

60A. **Paragraphs 40, 42 and 44 were amended and paragraph 40A added by *Improvements to IPSASs 2014* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2015. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2015, it shall disclose that fact.**

60B. **Paragraphs 56, 57, 58 and 61 were amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

60C. **IPSAS 35, *Consolidated Financial Statements* and IPSAS 37, *Joint Arrangements* issued in January 2015, amended paragraphs 3(a) and AG53. An entity shall apply those amendments when it applies IPSAS 35, and IPSAS 37.**

60D. **Paragraphs 7 and 8 were deleted by *The Applicability of IPSASs*, issued in April 2016. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2018. Earlier**

application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2018, it shall disclose that fact.

60E. **Paragraph 3 was amended by IPSAS 39, *Employee Benefits*, issued in July 2016. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2018 it shall disclose that fact and apply IPSAS 39 at the same time.**

60F. **Paragraphs 2, 3, 4, 9, 10, 14, 28, 36, 47, 48, AG2 and AG55 were amended, paragraph AG63 was deleted and paragraphs AG63A, AG63B, AG63C, AG63D, AG63E and AG63F were added by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply IPSAS 41 at the same time.**

60G. **Paragraph AG23 was amended by IPSAS 42, *Social Benefits*, issued in January 2019. An entity shall apply this amendment at the same time as it applies IPSAS 42.**

60H. **Paragraphs AG16 and AG17 were amended by IPSAS 43, *Leases* issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.**

61. When an entity adopts the accrual basis IPSASs of accounting as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

Withdrawal and Replacement of IPSAS 15 (2001)

62. This Standard and IPSAS 30 supersede IPSAS 15, issued in 2001. IPSAS 15 remains applicable until IPSAS 28 and IPSAS 30 are applied or become effective, whichever is earlier.

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 28.

AG1. This Application Guidance explains the application of particular aspects of the Standard.

AG2. The Standard does not deal with the recognition or measurement of financial instruments. Requirements about the recognition and measurement of financial assets and financial liabilities are set out in IPSAS 41.

Scope (paragraphs 3–6)

Financial Guarantee Contracts

AG3. Financial guarantee contracts are those contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original terms of a debt instrument. Governments may issue financial guarantees for a variety of reasons. They are often issued to further a government's policy objectives, for example, to support infrastructure projects and stabilize the financial market in times of distress. Governments and public sector entities may be granted the power to issue financial guarantees by legislation or other authority. In assessing whether a guarantee is contractual or non-contractual, an entity distinguishes the right to issue the guarantee and the actual issue of the guarantee. The right to issue the guarantee in terms of legislation or other authority is non-contractual, while the actual issue of the guarantee should be assessed using the principles in paragraph AG20 to determine whether the guarantee is contractual.

AG4. The issuing of financial guarantees in favor of a third party, whether explicitly or implicitly, may result in a contractual arrangement. Financial guarantees may be issued to a specific party or they may be issued to the holder of an instrument. Consider the following two examples:

- In a service concession arrangement, a government may issue a financial guarantee directly to the financiers of the transaction stating that, in the event of default, it would assume payment for any outstanding principal and interest payments of a loan. In this instance, the financial guarantee is explicitly issued in favor of an identified counterparty.
- Road authority A is responsible for constructing and maintaining a country's road infrastructure. It finances the construction of new roads by issuing long term bonds. National government A exercises its powers in legislation and guarantees the bond issue of road authority A. At the time the guarantee is issued, there are no specific counterparties that have been identified, rather the guarantee is implicitly issued in favor of the holders of a specific instrument.

In both these scenarios, assuming that all the other features of a contract are met, the financial guarantee is contractual in nature.

Insurance Contracts

AG5. Some economic entities in the public sector may include entities that issue insurance contracts. Those entities are within the scope of this Standard, but the insurance contracts themselves are outside the scope of this Standard.

AG6. For the purposes of this Standard, an insurance contract is a contract that exposes the insurer to identified risks of loss from events or circumstances occurring or discovered within a specified period, including death (i.e., in the case of an annuity, the survival of the annuitant), sickness, disability, property damage, injury to others, and interruption of operations. Additional guidance on insurance contracts is available in the relevant international or national standard dealing with insurance contracts.

AG7. Some financial instruments take the form of insurance contracts but principally involve the transfer of financial risks, such as market, credit, or liquidity risk. Examples of such instruments include financial guarantee contracts, reinsurance, and guaranteed investment contracts issued by public sector insurers and other entities. An entity is required to apply this Standard to certain financial guarantee contracts, and is permitted to apply this Standard to other insurance contracts that involve the transfer of financial risk.

AG8. Financial guarantee contracts are treated as financial instruments unless an entity elects to treat them as insurance contracts in accordance with this paragraph and also complies with the requirements of paragraph AG9. An entity may make this election in the following instances:

(a) If an entity previously applied accounting applicable to insurance contracts and adopted an accounting policy that treated financial guarantee contracts as insurance contracts, it may continue to treat such contracts either as insurance contracts or as financial instruments in accordance with this Standard.

(b) If an entity previously did not apply accounting applicable to insurance contracts, it may elect to treat financial guarantee contracts either as insurance contracts or as financial instruments when an entity adopts this Standard.

In both (a) and (b) above, the election is made on a contract by contract basis, and the choice is irrevocable.

AG9. In accordance with paragraph 3(c), an entity treats financial guarantee contracts as financial instruments unless it elects to treat such contracts as insurance contracts in accordance with the relevant international or national standard dealing with insurance contracts. An entity is permitted to treat a financial guarantee contract as an insurance contract using a national accounting standard only if that standard requires the measurement of insurance liabilities at an amount that is not less than the carrying amount that would be determined if the relevant insurance liabilities were within the scope of IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*. In determining the carrying amount of insurance liabilities, an entity considers the current estimates of all cash flows arising from its insurance contracts and of related cash flows.

Definitions (paragraphs 9–12)

Financial Assets and Financial Liabilities

AG10. Currency (cash) is a financial asset because it represents the medium of exchange and is therefore the basis on which all transactions are measured and recognized in financial statements. A deposit of cash with a bank or similar financial institution is a financial asset because it represents the contractual right of the depositor to obtain cash from the institution or to draw a check or similar instrument against the balance in favor of a creditor in payment of a financial liability. Unissued currency does not meet the definition of a financial instrument. An entity applies paragraph 13 of IPSAS 12, *Inventories* in accounting for any unissued currency. Currency issued as legal tender from the perspective of the issuer, is not addressed in this Standard.

AG11. Common examples of financial assets representing a contractual right to receive cash in the future and corresponding financial liabilities representing a contractual obligation to deliver cash in the future are:

(a) Accounts receivable and payable;

(b) Notes receivable and payable;

(c) Loans receivable and payable; and

(d) Bonds receivable and payable.

In each case, one party's contractual right to receive (or obligation to pay) cash is matched by the other party's corresponding obligation to pay (or right to receive).

AG12. Another type of financial instrument is one for which the economic benefit to be received or given up is a financial asset other than cash. For example, a note payable in government bonds gives the holder the contractual right to receive and the issuer the contractual obligation to deliver government bonds, not cash. The bonds are financial assets because they represent obligations of the issuing government to pay cash. The note is, therefore, a financial asset of the note holder and a financial liability of the note issuer.

AG13. "Perpetual" debt instruments (such as "perpetual" bonds, debentures and capital notes) normally provide the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very far in the future. For example, an entity may issue a financial instrument requiring it to make annual payments in perpetuity equal to a stated interest rate of 8 percent applied to a stated par or principal amount of CU1,000. Assuming 8 percent to be the market rate of interest for the instrument when issued, the issuer assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of CU1,000 on initial recognition. The holder and issuer of the instrument have a financial asset and a financial liability, respectively.

AG14. A contractual right or contractual obligation to receive, deliver or exchange financial instruments is itself a financial instrument. A chain of contractual rights or contractual obligations meets the definition of a financial instrument if it will ultimately lead to the receipt or payment of cash or to the acquisition or issue of an equity instrument.

AG15. The ability to exercise a contractual right or the requirement to satisfy a contractual obligation may be absolute, or it may be contingent on the occurrence of a future event. For example, a financial guarantee is a contractual right of the lender to receive cash from the guarantor, and a corresponding contractual obligation of the guarantor to pay the lender, if the borrower defaults. The contractual right and obligation exist because of a past transaction or event (assumption of the guarantee), even though the lender's ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on a future act of default by the borrower. A contingent right and obligation meet the definition of a financial asset and a financial liability, even though such assets and liabilities are not always recognized in the financial statements. Some of these contingent rights and obligations may be insurance contracts.

AG16. A lease typically creates an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. The lessor accounts for its investment in the amount receivable under a finance lease rather than the underlying asset itself that is subject to the finance lease. Accordingly, a lessor regards a finance lease as a financial instrument. Under IPSAS 43, *Leases* a lessor does not recognize its entitlement to receive lease payments under an operating lease. The lessor continues to account for the underlying asset itself rather than any amount receivable in the future under the contract. Accordingly, a lessor does not regard an operating lease as a financial instrument, except as regards individual payments currently due and payable by the lessee.

AG17. Physical assets (such as inventories, property, plant and equipment), right-of-use assets and intangible assets (such as patents and trademarks) are not financial assets. Control of such physical assets, right-of-use assets and intangible assets creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset.

AG18. Assets (such as prepaid expenses) for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets. Similarly, items such as deferred revenue and most warranty obligations are not financial liabilities because the outflow of economic benefits associated with them is the delivery of goods and services rather than a contractual obligation to pay cash or another financial asset.

AG19. Assets and liabilities in the public sector arise out of both contractual and non-contractual arrangements. Assets and liabilities arising out of non-contractual arrangements do not meet the definition of a financial asset or a financial liability.

AG20. An entity considers the substance rather than the legal form of an arrangement in determining whether it is a "contract" for purposes of this Standard. Contracts, for the purposes of this Standard, are generally evidenced by the following (although this may differ from jurisdiction to jurisdiction):

- Contracts involve willing parties entering into an arrangement;
- The terms of the contract create rights and obligations for the parties to the contract, and those rights and obligations need not result in equal performance by each party. For example, a donor funding arrangement creates an obligation for the donor to transfer resources to the recipient in terms of the agreement concluded, and establishes the right of the recipient to receive those resources. These types of arrangements may be contractual even though the recipient did not provide equal consideration in return i.e., the arrangement does not result in equal performance by the parties; and
- The remedy for non-performance is enforceable by law.

AG21. In the public sector, it is possible that contractual and non-contractual arrangements are non-exchange in nature. Assets and liabilities arising from non-exchange revenue transactions are accounted for in accordance with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. If non-exchange revenue transactions are contractual, an entity assesses if the assets or liabilities arising from such transactions are financial assets or financial liabilities by using paragraphs 10 and AG10–AG18 of this Standard. An entity uses the guidance in this Standard and IPSAS 23 in assessing whether a non-exchange transaction gives rise to a liability or an equity instrument (contribution from owners).

AG22. An entity would particularly consider the classification requirements of this Standard in determining whether an inflow of resources as part of a contractual non-exchange revenue transaction is in substance a liability or an equity instrument.

AG23. Statutory obligations can be accounted for in a number of ways:

- Obligations to pay income taxes are accounted for in accordance with the relevant international or national accounting standard dealing with income taxes.
- Obligations to provide social benefits are accounted for in accordance with IPSAS 42, *Social Benefits*.
- Other statutory obligations are accounted for in accordance with IPSAS 19.

AG24. Constructive obligations, as defined in IPSAS 19, also do not arise from contracts and are therefore not financial liabilities.

Equity Instruments

AG25. It is not common for entities in the public sector to have contributed capital comprising equity instruments, for example, shares and other forms of unitized capital. Where entities do issue equity instruments, the ownership and use of those instruments may be restricted by legislation. For example, legislation may stipulate that shares in a public sector entity may only be owned by another public sector entity and may therefore not be used as consideration for the settlement of transactions.

AG26. Contributed capital in the public sector may also be evidenced by transfers of resources between parties. The issuance of equity instruments in respect of a transfer of resources is not essential for the transfer to meet the definition of a contribution from owners. Transfers of resources that result in an interest in the net assets/equity of an entity are distinguished from other transfers of resources because they may be evidenced by the following:

- A formal designation of a transfer of resources (or a class of such transfers) by the parties to the transaction as forming part of an entity's net assets/equity, either before the contribution occurs or at the time of the contribution. For example, on establishing a new entity, the budget office of the department of finance may deem that the initial transfers of resources to an entity establish an interest in the net assets/equity of an entity rather than provide funding to meet operational requirements.
- A formal agreement, in relation to the transfer, establishing or increasing an existing financial interest in the net assets/equity of an entity that can be sold, transferred or redeemed.

Even though transfers of resources may be evidenced by a designation or formal agreement, an entity assesses the nature of transfers of resources based on their substance and not merely their legal form.

AG27. For the purposes of this Standard, the term "equity instrument" may be used to denote the following:

- A form of unitized capital such as ordinary or preference shares;
- Transfers of resources (either designated or agreed as such between the parties to the transaction) that evidence a residual interest in the net assets of another entity; and/or
- Financial liabilities in the legal form of debt that, in substance, represent an interest in an entity's net assets.

Puttable Instruments

AG28. Where an entity's contributed capital is comprised of shares or other forms of unitized capital, these instruments may take a number of forms, for example non-puttable ordinary shares, some puttable instruments (see paragraphs 15 and 16), some instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation (see paragraphs 17 and 18), some types of preference shares (see paragraphs AG49 and AG50), and warrants or written call options that allow the holder to subscribe for or purchase a fixed number of non-puttable ordinary shares in the issuing entity in exchange for a fixed amount of cash or another financial asset. An entity's obligation to issue or purchase a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument of the entity (except as stated in paragraph 27). However, if such a contract contains an obligation for the entity to pay cash or another financial asset (other than a contract classified as an equity instrument in accordance with paragraphs 15 and 16 or paragraphs 17 and 18), it also gives rise to a liability for the present value of the redemption amount (see paragraph AG51(a)). An issuer of non-puttable ordinary shares assumes a liability when it formally acts to make a distribution and becomes legally obliged to the shareholders to do so. This may be the case following the declaration of a dividend or when the entity is being wound up and any assets remaining after the satisfaction of liabilities become distributable to shareholders.

AG29. A purchased call option or other similar contract acquired by an entity that gives it the right to reacquire a fixed number of its own equity instruments in exchange for delivering a fixed amount of cash or another financial asset is not a financial asset of the entity (except as stated in paragraph 27). Instead, any consideration paid for such a contract is deducted from net assets/equity.

The Class of Instruments that is Subordinate to all Other Classes (paragraphs 15(b) and 17(b))

AG30. One of the features of paragraphs 15 and 17 is that the financial instrument is in the class of instruments that is subordinate to all other classes.

AG31. When determining whether an instrument is in the subordinate class, an entity evaluates the instrument's claim on liquidation as if it were to liquidate on the date when it classifies the instrument. An entity shall reassess the classification if there is a change in relevant circumstances. For example, if the entity issues or redeems another financial instrument, this may affect whether the instrument in question is in the class of instruments that is subordinate to all other classes.

AG32. An instrument that has a preferential right on liquidation of the entity is not an instrument with an entitlement to a pro rata share of the net assets of the entity. For example, an instrument has a preferential right on liquidation if it entitles the holder to a fixed dividend on liquidation, in addition to a share of the entity's net assets, when other instruments in the subordinate class with a right to a pro rata share of the net assets of the entity do not have the same right on liquidation.

AG33. If an entity has only one class of financial instruments, that class shall be treated as if it were subordinate to all other classes.

Total Expected Cash Flows Attributable to the Instrument over the Life of the Instrument (paragraph 15(e))

AG34. The total expected cash flows of the instrument over the life of the instrument must be substantially based on the surplus or deficit, change in the recognized net assets, or fair value of the recognized and unrecognized net assets of the entity over the life of the instrument. Surplus or deficit and the change in the recognized net assets shall be measured in accordance with relevant IPSASs.

Transactions Entered into by an Instrument Holder Other Than as Owner of the Entity (paragraphs 15 and 17)

AG35. The holder of a puttable financial instrument or an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation may enter into transactions with the entity in a role other than that of an owner. For example, an instrument holder also may be an employee of the entity. Only the cash flows and the contractual terms and conditions of the instrument that relate to the instrument holder as an owner of the entity shall be considered when assessing whether the instrument should be classified as an equity instrument under paragraph 15 or paragraph 17.

AG36. An example is a limited partnership that has limited and general partners. Some general partners may provide a guarantee to the entity and may be remunerated for providing that guarantee. In such situations, the guarantee and the associated cash flows relate to the instrument holders in their role as guarantors and not in their roles as owners of the entity. Therefore, such a guarantee and the associated cash flows would not result in the general partners being considered subordinate to the limited partners, and would be disregarded when assessing whether the contractual terms of the limited partnership instruments and the general partnership instruments are identical.

AG37. Another example is a surplus or deficit sharing arrangement that allocates surpluses and deficits to the instrument holders on the basis of services rendered or business generated during the current and previous years. Such arrangements are transactions with instrument holders in their role as non-owners and should not be considered when assessing the features listed in paragraph 15 or paragraph 17. However, such arrangements that allocate surpluses and deficits to instrument holders based on the nominal amount of their instruments relative to others in the class represent transactions with the instrument holders in their roles as owners and should be considered when assessing the features listed in paragraph 15 or paragraph 17.

AG38. The cash flows and contractual terms and conditions of a transaction between the instrument holder (in the role as a non-owner) and the issuing entity must be similar to an equivalent transaction that might occur between a non-instrument holder and the issuing entity.

No Other Financial Instrument or Contract with Total Cash Flows that Substantially Fixes or Restricts the Residual Return to the Instrument Holder (paragraphs 16 and 18)

AG39. A condition for classifying an equity instrument as a financial instrument that otherwise meets the criteria in paragraph 15 or paragraph 17 is that the entity has no other financial instrument or contract that has (a) total cash flows based substantially on the surplus or deficit, the change in the recognized net assets, or the change in the fair value of the recognized and unrecognized net assets of the entity and (b) the effect of substantially restricting or fixing the residual return. The following instruments, when entered into on normal commercial terms with unrelated parties, are unlikely to prevent instruments that otherwise meet the criteria in paragraph 15 or paragraph 17 from being classified as equity instruments:

(a) Instruments with total cash flows substantially based on specific assets of the entity.

(b) Instruments with total cash flows based on a percentage of revenue.

(c) Contracts designed to reward individual employees for services rendered to the entity.

(d) Contracts requiring the payment of an insignificant percentage of profit for services rendered or goods provided.

Derivative Financial Instruments

AG40. Financial instruments include primary instruments (such as receivables, payables and equity instruments) and derivative financial instruments (such as financial options, futures and forwards, interest rate swaps and currency swaps). Derivative financial instruments meet the definition of a financial instrument and, accordingly, are within the scope of this Standard.

AG41. Derivative financial instruments create rights and obligations that have the effect of transferring between the parties to the instrument one or more of the financial risks inherent in an underlying primary financial instrument. On inception, derivative financial instruments give one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are potentially favorable, or a contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavorable. However, they generally[1] do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a transfer necessarily take place on maturity of the contract. Some instruments embody both a right and an obligation to make an exchange. Because the terms of the exchange are determined on inception of the derivative instrument, as prices in financial markets change those terms may become either favorable or unfavorable.

AG42. A put or call option to exchange financial assets or financial liabilities (i.e., financial instruments other than an entity's own equity instruments) gives the holder a right to obtain potential future economic benefits associated with changes in the fair value of the financial instrument underlying the contract. Conversely, the writer of an option assumes an obligation to forgo potential future economic benefits or bear potential losses of economic benefits associated with changes in the fair value of the underlying financial instrument. The contractual right of the holder and obligation of the writer meet the definition of a financial asset and a financial liability, respectively. The financial instrument underlying an option contract may be any financial asset, including shares in other entities and interest-bearing instruments. An option may require the writer to issue a debt instrument, rather than transfer a financial asset, but the instrument underlying the option would constitute a financial asset of the holder if the option were exercised. The option-holder's right to exchange the financial asset under potentially favorable conditions and the writer's obligation to exchange the financial asset under potentially unfavorable conditions are distinct from the underlying financial asset to be exchanged upon exercise of the option. The nature of the holder's right and of the writer's obligation are not affected by the likelihood that the option will be exercised.

AG43. Another example of a derivative financial instrument is a forward contract to be settled in six months' time in which one party (the purchaser) promises to deliver CU1,000,000 cash in exchange for CU1,000,000 face amount of fixed rate government bonds, and the other party (the seller) promises to deliver CU1,000,000 face amount of fixed rate government bonds in exchange for CU1,000,000 cash. During the six months, both parties have a contractual right and a contractual obligation to exchange financial instruments. If the market price of the government bonds rises above CU1,000,000, the conditions will be favorable to the purchaser and unfavorable to the seller; if the market price falls below CU1,000,000, the effect will be the opposite. The purchaser has a contractual right (a financial asset) similar to the right under a call option held and a contractual obligation (a financial liability) similar to the obligation under a put option written; the seller has a contractual right (a financial asset) similar to the right under a put option held and a contractual obligation (a financial liability) similar to the obligation under a call option written. As with options, these contractual rights and obligations constitute financial assets and financial liabilities separate and distinct from the underlying financial instruments (the bonds and cash to be exchanged). Both parties to a forward contract have an obligation to perform at the agreed time, whereas performance under an option contract occurs only if and when the holder of the option chooses to exercise it.

AG44. Many other types of derivative instruments embody a right or obligation to make a future exchange, including interest rate and currency swaps, interest rate caps, collars and floors, loan commitments, note issuance facilities, and letters of credit. An interest rate swap contract may be viewed as a variation of a forward contract in which the parties agree to make a series of future exchanges of cash amounts, one amount calculated with reference to a floating interest rate and the other with reference to a fixed interest rate. Futures contracts are another variation of forward contracts, differing primarily in that the contracts are standardized and traded on an exchange.

Contracts to Buy or Sell Non-Financial Items (paragraphs 4–6)

AG45. Contracts to buy or sell non-financial items do not meet the definition of a financial instrument because the contractual right of one party to receive a non-financial asset or service and the corresponding obligation of the other party do not establish a present right or obligation of either party to receive, deliver or exchange a financial asset. For example, contracts that provide for settlement only by the receipt or delivery of a non-financial item (e.g., an option, futures or forward contract on oil) are not financial instruments. Many commodity contracts are of this type. Some are standardized in form and traded on organized markets in much the same fashion as some derivative financial instruments. For example, a commodity futures contract may be bought and sold readily for cash because it is listed for trading on an exchange and may change hands many times. However, the parties buying and selling the contract are, in effect, trading the underlying commodity. The ability to buy or sell a commodity contract for cash, the ease with which it may be bought or sold and the possibility of negotiating a cash settlement of the obligation to receive or deliver the commodity do not alter the fundamental character of the contract in a way that creates a financial instrument. Nevertheless, some contracts to buy or sell non-financial items that can be settled net or by exchanging financial instruments, or in which the non-financial item is readily convertible to cash, are within the scope of the Standard as if they were financial instruments (see paragraph 4).

[1] This is true of most, but not all derivatives, e.g., in some cross-currency interest rate swaps principal is exchanged on inception (and re-exchanged on maturity).

AG46. A contract that involves the receipt or delivery of physical assets does not give rise to a financial asset of one party and a financial liability of the other party unless any corresponding payment is deferred past the date on which the physical assets are transferred. Such is the case with the purchase or sale of goods on credit.

AG47. Some contracts are commodity-linked, but do not involve settlement through the physical receipt or delivery of a commodity. They specify settlement through cash payments that are determined according to a formula in the contract, rather than through payment of fixed amounts. For example, the principal amount of a bond may be calculated by applying the market price of oil prevailing at the maturity of the bond to a fixed quantity of oil. The principal is indexed by reference to a commodity price, but is settled only in cash. Such a contract constitutes a financial instrument.

AG48. The definition of a financial instrument also encompasses a contract that gives rise to a non-financial asset or non-financial liability in addition to a financial asset or financial liability. Such financial instruments often give one party an option to exchange a financial asset for a non-financial asset. For example, an oil-linked bond may give the holder the right to receive a stream of fixed periodic interest payments and a fixed amount of cash on maturity, with the option to exchange the principal amount for a fixed quantity of oil. The desirability of exercising this option will vary from time to time depending on the fair value of oil relative to the exchange ratio of cash for oil (the exchange price) inherent in the bond. The intentions of the bondholder concerning the exercise of the option do not affect the substance of the component assets. The financial asset of the holder and the financial liability of the issuer make the bond a financial instrument, regardless of the other types of assets and liabilities also created.

Presentation

Liabilities and Net Assets/Equity (paragraphs 13–32)

No Contractual Obligation to Deliver Cash or another Financial Asset (paragraphs 21–24)

AG49. Preference shares may be issued with various rights. In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a preference share that provides for redemption on a specific date or at the option of the holder contains a financial liability because the issuer has an obligation to transfer financial assets to the holder of the share. The potential inability of an issuer to satisfy an obligation to redeem a preference share when contractually required to do so, whether because of a lack of funds, a statutory restriction, or insufficient surpluses or reserves, does not negate the obligation. An option of the issuer to redeem the shares for cash does not satisfy the definition of a financial liability because the issuer does not have a present obligation to transfer financial assets to the shareholders. In this case, redemption of the shares is solely at the discretion of the issuer. An obligation may arise, however, when the issuer of the shares exercises its option, usually by formally notifying the shareholders of an intention to redeem the shares.

AG50. When preference share s are non-redeemable, the appropriate classification is determined by the other rights that attach to them. Classification is based on an assessment of the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. When distributions to holders of the preference shares, whether cumulative or non-cumulative, are at the discretion of the issuer, the shares are equity instruments. The classification of a preference share as an equity instrument or a financial liability is not affected by, for example:

(a) A history of making distributions;

(b) An intention to make distributions in the future;

(c) A possible negative impact on the price of ordinary shares of the issuer if distributions are not made (because of restrictions on paying dividends on the ordinary shares if dividends are not paid on the preference shares);

(d) The amount of the issuer's reserves;

(e) An issuer's expectation of a surplus or deficit for a period; or

(f) An ability or inability of the issuer to influence the amount of its surplus or deficit for the period.

Settlement in the Entity's Own Equity Instruments (paragraphs 25–29)

AG51. As noted in paragraph AG25, it is not common for entities in the public sector to issue equity instruments comprising shares or other forms of unitized capital; and where such instruments do exist, their use and ownership is usually restricted in legislation. As a result of the capital structure of public sector entities generally being different from private sector entities, and the legislative environment in which public sector entities operate, transactions that are settled in an entity's own equity instruments are not likely to occur as frequently in the public sector as in the private sector. However, where such transactions do occur, the following examples may assist in illustrating how to classify different types of contracts on an entity's own equity instruments:

(a) A contract that will be settled by the entity receiving or delivering a fixed number of its own shares for no future consideration, or exchanging a fixed number of its own shares for a fixed amount of cash or another financial asset, is an equity instrument (except as stated in paragraph 27). Accordingly, any consideration received or paid for such a contract is added directly to or deducted directly from net assets/equity. One example is an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed amount of cash. However, if the contract requires the entity to purchase (redeem) its own shares for cash or another financial asset at a fixed or determinable date or on demand, the entity also recognizes a financial liability for the present value of the redemption amount (with the exception of instruments that have all the features and meet the conditions in paragraph 15 and 16 or paragraphs 17 and 18). One example is an entity's obligation under a forward contract to repurchase a fixed number of its own shares for a fixed amount of cash.

(b) An entity's obligation to purchase its own shares for cash gives rise to a financial liability for the present value of the redemption amount even if the number of shares that the entity is obliged to repurchase is not fixed or if the obligation is conditional on the counterparty exercising a right to redeem (except as stated in paragraphs 15 and 16 or paragraphs 17 and 18). One example of a conditional obligation is an issued option that requires the entity to repurchase its own shares for cash if the counterparty exercises the option.

(c) A contract that will be settled in cash or another financial asset is a financial asset or financial liability even if the amount of cash or another financial asset that will be received or delivered is based on changes in the market price of the entity's own equity instruments (except as stated in paragraphs 15 and 16 or paragraphs 17 and 18). One example is a net cash-settled share option.

A contract that will be settled in a variable number of the entity's own shares whose value equals a fixed amount or an amount based on changes in an underlying variable (e.g., a commodity price) is a financial asset or a financial liability. An example is a written option to buy oil that, if exercised, is settled net in the entity's own instruments by the entity delivering as many of those instruments as are equal to the value of the option contract. Such a contract is a financial asset or financial liability even if the underlying variable is the entity's own share price rather than oil. Similarly, a contract that will be settled in a fixed number of the entity's own shares, but the rights attaching to those shares will be varied so that the settlement value equals a fixed amount or an amount based on changes in an underlying variable, is a financial asset or a financial liability.

Contingent Settlement Provisions (paragraph 30)

AG52. Paragraph 30 requires that if a part of a contingent settlement provision that could require settlement in cash or another financial asset (or in another way that would result in the instrument being a financial liability) is not genuine, the settlement provision does not affect the classification of a financial instrument. Thus, a contract that requires settlement in cash or a variable number of the entity's own shares only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur is an equity instrument. Similarly, settlement in a fixed number of an entity's own shares may be contractually precluded in circumstances that are outside the control of the entity, but if these circumstances have no genuine possibility of occurring, classification as an equity instrument is appropriate.

Treatment in Consolidated Financial Statements

AG53. In consolidated financial statements, an entity presents non-controlling interests i.e., the interests of other parties in the net assets/equity and revenue of its controlled entities in accordance with IPSAS 1 and IPSAS 35. When classifying a financial instrument (or a component of it) in consolidated financial statements, an entity considers all terms and conditions agreed between members of the economic entity and the holders of the instrument in determining whether the economic entity as a whole has an obligation to deliver cash or another financial asset in respect of the instrument or to settle it in a manner that results in liability classification. When a controlled entity issues a financial instrument and a controlling entity or other entity within the economic entity agrees additional terms directly with the holders of the instrument (e.g., a guarantee), the economic entity may not have discretion over distributions or redemption. Although the controlled entity may appropriately classify the instrument without regard to these additional terms in its individual financial statements, the effect of other agreements between members of the economic entity and the holders of the instrument is considered in order to ensure that consolidated financial statements reflect the contracts and transactions entered into by the economic entity as a whole. To the extent that there is such an obligation or settlement provision, the instrument (or the component of it that is subject to the obligation) is classified as a financial liability in consolidated financial statements.

AG54. Some types of instruments that impose a contractual obligation on the entity are classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. Classification in accordance with those paragraphs is an exception to the principles otherwise applied in this Standard to the classification of an instrument and cannot be applied by analogy to other instruments. This exception is not extended to the classification of non-controlling interests in the consolidated financial statements. Therefore, instruments classified as equity instruments in accordance with either paragraphs 15 and 16 or paragraphs 17 and 18 in the separate or individual financial statements that are non-controlling interests are classified as liabilities in the consolidated financial statements of the economic entity.

Compound Financial Instruments (paragraphs 33–37)

AG55. Paragraph 33 applies only to issuers of non-derivative compound financial instruments. Paragraph 33 does not deal with compound financial instruments from the perspective of holders. IPSAS 41 deals with the classification and measurement of financial assets that are compound financial instruments from the holder's perspective.

AG56. Compound financial instruments are not common in the public sector because of the capital structure of public sector entities. The following discussion does, however, illustrate how a compound financial instrument would be analyzed into its component parts. A common form of compound financial instrument is a debt instrument with an embedded conversion option, such as a bond convertible into ordinary shares of the issuer, and without any other embedded derivative features. Paragraph 33 requires the issuer of such a financial instrument to present the liability component and net assets/equity component separately in the statement of financial position, as follows:

(a) The issuer's obligation to make scheduled payments of interest and principal is a financial liability that exists as long as the instrument is not converted. On initial recognition, the fair value of the liability component is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option.

(b) The equity instrument is an embedded option to convert the liability into net assets/equity of the issuer. The fair value of the option comprises its time value and its intrinsic value, if any. This option has value on initial recognition even when it is out of the money.

AG57. On conversion of a convertible instrument at maturity, the entity derecognizes the liability component and recognizes it as net assets/equity. The original net assets/equity component remains as net assets/equity (although it may be transferred from one line item within net assets/equity to another.) There is no gain or loss on conversion at maturity.

AG58. When an entity extinguishes a convertible instrument before maturity through an early redemption or repurchase in which the original conversion privileges are unchanged, the entity allocates the consideration paid and any transaction costs for the repurchase or redemption to the components of the instrument at the date of the transaction. The method used in allocating the consideration paid and transaction costs to the separate components is consistent with that used in the original allocation to the separate components of the proceeds received by the entity when the convertible instrument was issued, in accordance with paragraphs 33–37.

AG59. Once the allocation of the consideration is made, any resulting gain or loss is treated in accordance with accounting principles applicable to the related component, as follows:

(a) The amount of gain or loss relating to the liability component is recognized in surplus or deficit; and

(b) The amount of consideration relating to the net assets/equity component is recognized in net assets/equity.

AG60. An entity may amend the terms of a convertible instrument to induce early conversion, for example by offering a more favorable conversion ratio or paying other additional consideration in the event of conversion before a specified date. The difference, at the date the terms are amended, between the fair value of the consideration the holder receives on conversion of the instrument under the revised terms and the fair value of the consideration the holder would have received under the original terms is recognized as a loss in surplus or deficit.

Treasury Shares (paragraphs 38 and 39)

AG61. An entity's own equity instruments are not recognized as a financial asset regardless of the reason for which they are reacquired. Paragraph 38 requires an entity that reacquires its own equity instruments to deduct those equity instruments from net assets/equity. However, when an entity holds its own equity instruments on behalf of others, for example, a financial institution holding its own equity instruments on behalf of a client, there is an agency relationship and as a result those holdings are not included in the entity's statement of financial position.

Interest, Dividends or Similar Distributions, Losses, and Gains (paragraphs 40–46)

AG62. The following example illustrates the application of paragraph 40 to a compound financial instrument. Assume that a non-cumulative preference share is mandatorily redeemable for cash in five years, but that dividends are payable at the discretion of the entity before the redemption date. Such an instrument is a compound financial instrument, with the liability component being the present value of the redemption amount. The unwinding of the discount on this component is recognized in surplus or deficit and classified as interest expense. Any dividends paid relate to the net assets/equity component and, accordingly, are recognized as a distribution of surplus or deficit. A similar treatment would apply if the redemption was not mandatory but at the option of the holder, or if the share was mandatorily convertible into a variable number of ordinary shares calculated to equal a fixed amount or an amount based on changes in an underlying variable (for example, a commodity). However, if any unpaid dividends or similar distributions are added to the redemption amount, the entire instrument is a liability. In such a case, any dividends or similar distributions are classified as interest expense.

Offsetting a Financial Asset and a Financial Liability (paragraphs 47–55)

AG63. [Deleted]

Criterion that an Entity 'Currently has a Legally Enforceable Right to Set Off the Recognized Amounts' (paragraph 47(a))

AG63A. A right of set-off may be currently available or it may be contingent on a future event (for example, the right may be triggered or exercisable only on the occurrence of some future event, such as the default, insolvency or bankruptcy of one of the counterparties). Even if the right of set-off is not contingent on a future event, it may only be legally enforceable in the normal course of operations, or in the event of default, or in the event of insolvency or bankruptcy, of one or all of the counterparties.

AG63B. To meet the criterion in paragraph 47(a), an entity must currently have a legally enforceable right of set-off. This means that the right of set-off:

(a) Must not be contingent on a future event; and

(b) Must be legally enforceable in all of the following circumstances:

  (i) The normal course of operations;

  (ii) The event of default; and

  (iii) The event of insolvency or bankruptcy of the entity and all of the counterparties.

AG63C. The nature and extent of the right of set-off, including any conditions attached to its exercise and whether it would remain in the event of default or insolvency or bankruptcy, may vary from one legal jurisdiction to another. Consequently, it cannot be assumed that the right of set-off is automatically available outside of the normal course of operations. For example, the bankruptcy or insolvency laws of a jurisdiction may prohibit, or restrict, the right of set-off in the event of bankruptcy or insolvency in some circumstances.

AG63D. The laws applicable to the relationships between the parties (for example, contractual provisions, the laws governing the contract, or the default, insolvency or bankruptcy laws applicable to the parties) need to be considered to ascertain whether the right of set-off is enforceable in the normal course of operations, in an event of default, and in the event of insolvency or bankruptcy, of the entity and all of the counterparties (as specified in paragraph AG63B(b)).

Criterion that an Entity 'Intends Either to Settle on a Net Basis, or to Realize the Asset and Settle the Liability Simultaneously' (paragraph 47(b))

AG63E. To meet the criterion in paragraph 47(b) an entity must intend either to settle on a net basis or to realize the asset and settle the liability simultaneously. Although the entity may have a right to settle net, it may still realize the asset and settle the liability separately.

AG63F. If an entity can settle amounts in a manner such that the outcome is, in effect, equivalent to net settlement, the entity will meet the net settlement criterion in paragraph 47(b). This will occur if, and only if, the gross settlement mechanism has features that eliminate or result in insignificant credit and liquidity risk, and that will process receivables and payables in a single settlement process or cycle. For example, a gross settlement system that has all of the following characteristics would meet the net settlement criterion in paragraph 47(b):

(a) Financial assets and financial liabilities eligible for set-off are submitted at the same point in time for processing;

(b) Once the financial assets and financial liabilities are submitted for processing, the parties are committed to fulfil the settlement obligation;

(c) There is no potential for the cash flows arising from the assets and liabilities to change once they have been submitted for processing (unless the processing fails—see (d) below);

(d) Assets and liabilities that are collateralized with securities will be settled on a securities transfer or similar system (for example, delivery versus payment), so that if the transfer of securities fails, the processing of the related receivable or payable for which the securities are collateral will also fail (and vice versa);

(e) Any transactions that fail, as outlined in (d), will be re-entered for processing until they are settled;

(f) Settlement is carried out through the same settlement institution (for example, a settlement bank, a central bank or a central securities depository); and

(g) An intraday credit facility is in place that will provide sufficient overdraft amounts to enable the processing of payments at the settlement date for each of the parties, and it is virtually certain that the intraday credit facility will be honored if called upon.

AG64. The Standard does not provide special treatment for so-called "synthetic instruments," which are groups of separate financial instruments acquired and held to emulate the characteristics of another instrument. For example, a floating rate long-term debt combined with an interest rate swap that involves receiving floating payments and making fixed payments synthesizes a fixed rate long-term debt. Each of the individual financial instruments that together constitute a "synthetic instrument" represents a contractual right or obligation with its own terms and conditions and each may be transferred or settled separately. Each financial instrument is exposed to risks that may differ from the risks to which other financial instruments are exposed. Accordingly, when one financial instrument in a "synthetic instrument" is an asset and another is a liability, they are not offset and presented in an entity's statement of financial position on a net basis unless they meet the criteria for offsetting in paragraph 47.

Appendix B

Members' Shares in Co-operative Entities and Similar Instruments

This Appendix is an integral part of IPSAS 28.

Introduction

B1. Co-operatives and other similar entities are formed by groups of persons to meet common economic or social needs. National laws typically define a co-operative as a society endeavoring to promote its members' economic advancement by way of a joint business operation (the principle of self-help). Members' interests in a co-operative are often characterised as members' shares, units or the like, and are referred to below as "members' shares." This Appendix applies to financial instruments issued to members of co-operative entities that evidence the members' ownership interest in the entity and does not apply to financial instruments that will or may be settled in the entity's own equity instruments.

B2. IPSAS 28 establishes principles for the classification of financial instruments as financial liabilities or net assets/equity. In particular, those principles apply to the classification of puttable instruments that allow the holder to put those instruments to the issuer for cash or another financial instrument. The application of those principles to members' shares in co-operative entities and similar instruments is difficult. This guidance is provided to illustrate the application of the principles in IPSAS 28 to members' shares and similar instruments that have certain features, and the circumstances in which those features affect the classification as liabilities or net assets/equity.

B3. Many financial instruments, including members' shares, have characteristics of equity instruments, including voting rights and rights to participate in dividend or similar distributions. Some financial instruments give the holder the right to request redemption for cash or another financial asset, but may include or be subject to limits on whether the financial instruments will be redeemed. The following paragraphs outline how those redemption terms should be evaluated in determining whether the financial instruments should be classified as liabilities or net assets/equity.

Application of IPSASs to Members' Shares in Co-operative Entities and Similar Instruments

B4. The contractual right of the holder of a financial instrument (including members' shares in co-operative entities) to request redemption does not, in itself, require that financial instrument to be classified as a financial liability. Rather, the entity must consider all of the terms and conditions of the financial instrument in determining its classification as a financial liability or an equity instrument. Those terms and conditions include relevant local laws, regulations and the entity's governing charter in effect at the date of classification, but not expected future amendments to those laws, regulations or charter.

B5. Members' shares that would be classified as equity instruments if the members did not have a right to request redemption are equity instruments if either of the conditions described in paragraphs B6 and B7 is present or the members' shares have all the features and meet the conditions in paragraphs 15 and 16 or paragraphs 17 and 18 of IPSAS 28. Demand deposits, including current accounts, deposit accounts and similar contracts that arise when members act as customers are financial liabilities of the entity.

B6. Members' shares are equity instruments if the entity has an unconditional right to refuse redemption of the members' shares.

B7. Local law, regulation or the entity's governing charter can impose various types of prohibitions on the redemption of members' shares, e.g., unconditional prohibitions or prohibitions based on liquidity criteria. If redemption is unconditionally prohibited by local law, regulation or the entity's governing charter, members' shares are equity instruments. However, provisions in local law, regulation or the entity's governing charter that prohibit redemption only if conditions—such as liquidity constraints—are met (or are not met) do not result in members' shares being equity instruments.

B8. An unconditional prohibition may be absolute, in that all redemptions are prohibited. An unconditional prohibition may be partial, in that it prohibits redemption of members' shares if redemption would cause the number of members' shares or amount of paid-in capital from members' shares to fall below a specified level. Members' shares in excess of the prohibition against redemption are liabilities, unless the entity has the unconditional right to refuse redemption as described in paragraph B6 or the members' shares have all the features and meet the conditions in paragraphs 15 and 16 or paragraphs 17 and 18 of IPSAS 28. In some cases, the number of shares or the amount of paid-in capital subject to a redemption prohibition may change from time to time. Such a change in the redemption prohibition leads to a transfer between financial liabilities and net assets/equity.

B9. At initial recognition, the entity shall measure its financial liability for redemption at fair value. In the case of members' shares with a redemption feature, the entity measures the fair value of the financial liability for redemption at no less than the maximum amount payable under the redemption provisions of its governing charter or applicable law discounted from the first date that the amount could be required to be paid (see example 3).

B10. As required by paragraph 40 of IPSAS 28, distributions to holders of equity instruments are recognized directly in net assets/equity, net of any income tax benefits. Interest, dividends or similar distributions and other returns relating to financial instruments classified as financial liabilities are expenses, regardless of whether those amounts paid are legally characterized as dividends or similar distributions, interest or otherwise.

B11. When a change in the redemption prohibition leads to a transfer between financial liabilities and net assets/equity, the entity shall disclose separately the amount, timing and reason for the transfer.

B12. The following examples illustrate the application of the preceding paragraphs.

Illustrative Examples

The examples do not constitute an exhaustive list; other fact patterns are possible. Each example assumes that there are no conditions other than those set out in the facts of the example that would require the financial instrument to be classified as a financial liability and that the financial instrument does not have all the features or does not meet the conditions in paragraph 15 and 16 or paragraphs 17 and 18 of IPSAS 28.

Unconditional Right to Refuse Redemption (paragraph B6)

Example 1

Facts

B13. The entity's charter states that redemptions are made at the sole discretion of the entity. The charter does not provide further elaboration or limitation on that discretion. In its history, the entity has never refused to redeem members' shares, although the governing board has the right to do so.

Classification

B14. The entity has the unconditional right to refuse redemption and the members' shares are equity instruments. IPSAS 28 establishes principles for classification that are based on the terms of the financial instrument and notes that a history of, or intention to make, discretionary payments does not trigger liability classification. Paragraph AG50 of IPSAS 28 states:

> When preference shares are non-redeemable, the appropriate classification is determined by the other rights that attach to them. Classification is based on an assessment of the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. When distributions to holders of the preference shares, whether cumulative or non-cumulative, are at the discretion of the issuer, the shares are equity instruments. The classification of a preference share as an equity instrument or a financial liability is not affected by, for example:
>
> (a) A history of making distributions;
>
> (b) An intention to make distributions in the future;
>
> (c) A possible negative impact on the price of ordinary shares of the issuer if distributions are not made (because of restrictions on paying dividends on the ordinary shares if dividends are not paid on the preference shares);
>
> (d) The amount of the issuer's reserves;
>
> (e) An issuer's expectation of a surplus or deficit for a period; or
>
> (f) An ability or inability of the issuer to influence the amount of its surplus or deficit for the period.

Example 2

Facts

B15. The entity's charter states that redemptions are made at the sole discretion of the entity. However, the charter further states that approval of a redemption request is automatic unless the entity is unable to make payments without violating local regulations regarding liquidity or reserves.

Classification

B16. The entity does not have the unconditional right to refuse redemption and the members' shares are classified as a financial liability. The restrictions described above are based on the entity's ability to settle its liability. They restrict redemptions only if the liquidity or reserve requirements are not met and then only until such time as they are met. Hence, they do not, under the principles established in IPSAS 28, result in the classification of the financial instrument as equity instruments. Paragraph AG49 of IPSAS 28 states:

> Preference shares may be issued with various rights. In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a preference share that provides for redemption on a specific date or at the option of the holder contains a financial liability because the issuer has an obligation to transfer financial assets to the holder of the share. *The potential inability of an issuer to satisfy an obligation to redeem a preference share when contractually required to do so, whether because of a lack of funds, a statutory restriction or insufficient surpluses or reserves, does not negate the obligation.* [Emphasis added]

Prohibitions against Redemption (paragraphs B7 and B8)

Example 3

Facts

B17. A co-operative entity has issued shares to its members at different dates and for different amounts in the past as follows:

(a) January 1, 20X1 100,000 shares at CU10 each (CU1,000,000);

(b) January 1, 20X2 100,000 shares at CU20 each (a further CU2,000,000, so that the total for shares issued is CU3,000,000).

Shares are redeemable on demand at the amount for which they were issued.

B18. The entity's charter states that cumulative redemptions cannot exceed 20 percent of the highest number of its members' shares ever outstanding. At December 31, 20X2 the entity has 200,000 of outstanding shares, which is the highest number of members' shares ever outstanding and no shares have been redeemed in the past. On January 1, 20X3 the entity amends its governing charter and increases the permitted level of cumulative redemptions to 25 percent of the highest number of its members' shares ever outstanding.

Classification

<u>Before the Governing Charter is Amended</u>

B19. Members' shares in excess of the prohibition against redemption are financial liabilities. The co-operative entity measures this financial liability at fair value at initial recognition. Because these shares are redeemable on demand, the co-operative entity measures the fair value of such financial liabilities in accordance with paragraph 68 of IPSAS 41, which states: "The fair value of a financial liability with a demand feature (e.g., a demand deposit) is not less than the amount payable on demand …" Accordingly, the co-operative entity classifies as financial liabilities the maximum amount payable on demand under the redemption provisions.

B20. On January 1, 20X1 the maximum amount payable under the redemption provisions is 20,000 shares at CU10 each and accordingly the entity classifies CU200,000 as financial liability and CU800,000 as equity instruments. However, on January 1, 20X2 because of the new issue of shares at CU20, the maximum amount payable under the redemption provisions increases to 40,000 shares at CU20 each. The issue of additional shares at CU20 creates a new liability that is measured on initial recognition at fair value. The liability after these shares have been issued is 20 percent of the total shares in issue (200,000), measured at CU20, or CU800,000. This requires recognition of an additional liability of CU600,000. In this example no gain or loss is recognized. Accordingly the entity now classifies CU800,000 as financial liabilities and CU2,200,000 as equity instruments. This example assumes these amounts are not changed between January 1, 20X1 and December 31, 20X2.

<u>After the Governing Charter is Amended</u>

B21. Following the change in its governing charter the co-operative entity can now be required to redeem a maximum of 25 percent of its outstanding shares or a maximum of 50,000 shares at CU20 each. Accordingly, on January 1, 20X3 the co-operative entity classifies as financial liabilities an amount of CU1,000,000 being the maximum amount payable on demand under the redemption provisions, as determined in accordance with paragraph 68 of IPSAS 41. It therefore transfers on January 1, 20X3 from net assets/equity to financial liabilities an amount of CU200,000, leaving CU2,000,000 classified as equity instruments. In this example the entity does not recognize a gain or loss on the transfer.

Example 4

Facts

B22. Local law governing the operations of co-operatives, or the terms of the entity's governing charter, prohibit an entity from redeeming members' shares if, by redeeming them, it would reduce paid-in capital from members' shares below 75 percent of the highest amount of paid-in capital from members' shares. The highest amount for a particular co-operative is CU1,000,000. At the end of the reporting period the balance of paid-in capital is CU900,000.

Classification

B23. In this case, CU750,000 would be classified as equity instruments and CU150,000 would be classified as financial liabilities. In addition to the paragraphs already cited, paragraph 22(b) of IPSAS 28 states in part:

> … a financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset (a "puttable instrument") is a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. The financial instrument is a financial liability even when the amount of cash or other financial assets is determined on the basis of an index or other item that has the potential to increase or decrease. The existence of an option for the holder to put the instrument back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18.

B24. The redemption prohibition described in this example is different from the restrictions described in paragraphs 23 and AG49 of IPSAS 28. Those restrictions are limitations on the ability of the entity to pay the amount due on a financial liability, i.e., they prevent payment of the liability only if specified conditions are met. In contrast, this example describes an unconditional prohibition on redemptions beyond a specified amount, regardless of the entity's ability to redeem members' shares (e.g., given its cash resources, surpluses or distributable reserves). In effect, the prohibition against redemption prevents the entity from incurring any financial liability to redeem more than a specified amount of paid-in capital. Therefore, the portion of shares subject to the redemption prohibition is not a financial liability. While each member's shares may be redeemable individually, a portion of the total shares outstanding is not redeemable in any circumstances other than liquidation of the entity.

Example 5

Facts

B25. The facts of this example are as stated in example 4. In addition, at the end of the reporting period, liquidity requirements imposed in the local jurisdiction prevent the entity from redeeming any members' shares unless its holdings of cash and short-term investments are greater than a specified amount. The effect of these liquidity requirements at the end of the reporting period is that the entity cannot pay more than CU50,000 to redeem the members' shares.

Classification

B26. As in example 4, the entity classifies CU750,000 as equity instruments and CU150,000 as a financial liability. This is because the amount classified as a liability is based on the entity's unconditional right to refuse redemption and not on conditional restrictions that prevent redemption only if liquidity or other conditions are not met and then only until such time as they are met. The provisions of paragraphs 23 and AG49 of IPSAS 28 apply in this case.

Example 6

Facts

B27. The entity's governing charter prohibits it from redeeming members' shares, except to the extent of proceeds received from the issue of additional members' shares to new or existing members during the preceding three years. Proceeds from issuing members' shares must be applied to redeem shares for which members have requested redemption. During the three preceding years, the proceeds from issuing members' shares have been CU12,000 and no member's shares have been redeemed.

Classification

B28. The entity classifies CU12,000 of the members' shares as financial liabilities. Consistently with the conclusions described in example 4, members' shares subject to an unconditional prohibition against redemption are not financial liabilities. Such an unconditional prohibition applies to an amount equal to the proceeds of shares issued before the preceding three years, and accordingly, this amount is classified as equity instruments. However, an amount equal to the proceeds from any shares issued in the preceding three years is not subject to an unconditional prohibition on redemption. Accordingly, proceeds from the issue of members' shares in the preceding three years give rise to financial liabilities until they are no longer available for redemption of members' shares. As a result the entity has a financial liability equal to the proceeds of shares issued during the three preceding years, net of any redemptions during that period.

Example 7

Facts

B29. The entity is a co-operative bank. Local law governing the operations of co-operative banks state that at least 50 percent of the entity's total "outstanding liabilities" (a term defined in the regulations to include members' share accounts) has to be in the form of members' paid-in capital. The effect of the regulation is that if all of a co-operative's outstanding liabilities are in the form of members' shares, it is able to redeem them all. On December 31, 20X1 the entity has total outstanding liabilities of CU200,000, of which CU125,000 represent members' share accounts. The terms of the members' share accounts permit the holder to redeem them on demand and there are no limitations on redemption in the entity's charter.

Classification

B30. In this example members' shares are classified as financial liabilities. The redemption prohibition is similar to the restrictions described in paragraphs 23 and AG49 of IPSAS 28. The restriction is a conditional limitation on the ability of the entity to pay the amount due on a financial liability, i.e., they prevent payment of the liability only if specified conditions are met. More specifically, the entity could be required to redeem the entire amount of members' shares (CU125,000) if it repaid all of its other liabilities (CU75,000). Consequently, the prohibition against redemption does not prevent the entity from incurring a financial liability to redeem more than a specified number of members' shares or amount of paid-in capital. It allows the entity only to defer redemption until a condition is met, i.e., the repayment of other liabilities. Members' shares in this example are not subject to an unconditional prohibition against redemption and are therefore classified as financial liabilities.

Appendix C

Amendments to Other IPSASs

[Deleted]

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 28.

Introduction

BC1. This Basis for Conclusions summarizes the International Public Sector Accounting Standards Board's (IPSASB) considerations in reaching the conclusions in IPSAS 28, *Financial Instruments: Presentation*. As this Standard is primarily drawn from IAS 32, *Financial Instruments: Presentation* issued by the International Accounting Standards Board (IASB), the Basis for Conclusions outlines only those areas where the IPSAS 28 departs from the main requirements of IAS 32.

BC2. This project on financial instruments is a key part of the IPSASB's convergence program, which aims to converge IPSASs with International Financial Reporting Standards (IFRSs). The IPSASB acknowledges that there are other aspects of financial instruments, in so far as they relate to the public sector, which are not addressed in IAS 32. These may be addressed by future projects of the IPSASB. In particular, the IPSASB acknowledges that future projects may be required to address:

- Certain transactions undertaken by central banks; and
- Receivables and payables that arise from arrangements that are, in substance, similar to, and have the same economic effect as, financial instruments, but are not contractual in nature.

BC3. In developing this Standard, the IPSASB agreed to retain the existing text of IAS 32, making changes to ensure consistency with the terminology and presentational requirements of other IPSASs, and deal with any public sector specific issues through additional Application Guidance.

BC4. In September 2007, the IASB issued amendments to IAS 1, *Presentation of Financial Statements* which introduced "comprehensive income" into the presentation of financial statements. As the IPSASB has not yet considered comprehensive income, along with some of the other amendments to IAS 1, those amendments have not been included in IPSAS 28.

Scope

Insurance and Financial Guarantee Contracts

BC5. IAS 32 excludes all insurance contracts from the scope of IAS 32, except for financial guarantee contracts where the issuer applies IFRS 9, *Financial Instruments* in recognizing and measuring such contracts. The scope of IPSAS 28 also excludes all insurance contracts, except that:

- Financial guarantee contracts are to be treated as financial instruments unless an entity elects to treat such contracts as insurance contracts in accordance with the relevant international or national accounting standard dealing with insurance contracts; and
- Contracts that are insurance contracts but involve the transfer of financial risk may be treated as financial instruments in accordance with IPSAS 28, IPSAS 30 and IPSAS 41.

Treating Financial Guarantees as Financial Instruments

BC6. Under IAS 32, financial guarantee contracts should be treated as financial instruments, unless an issuer elects to apply IFRS 4 to those contracts. Unlike in the private sector, many financial guarantee contracts are issued in the public sector by way of a non-exchange transaction, i.e., at no or nominal consideration. So as to enhance the comparability of financial statements and, given the significance of financial guarantee contracts issued by way of non-exchange transactions in the public sector, the IPSASB had proposed that such guarantees should be treated as financial instruments and entities should not be permitted to treat them as insurance contracts.

BC7. In response to this proposal, some respondents agreed that the treatment of financial guarantee contracts issued through non-exchange transactions as financial instruments, rather than as insurance contracts, is appropriate because the business models for exchange and non-exchange insurance contracts are different. Others argued that entities should be allowed to treat such guarantees as insurance contracts or financial instruments using an election similar to that in IFRS 4.

BC8. The IPSASB concluded that the same approach should be applied to financial guarantee contracts, regardless of whether they are issued through exchange or non-exchange transactions, because the underlying liability that should be recognized in an entity's financial statements does not differ. The IPSASB agreed that entities should be permitted a choice of treating financial guarantee contracts, either as insurance contracts or financial instruments, subject to certain conditions.

BC9. In evaluating the circumstances under which an entity may elect to treat financial guarantee contracts as insurance contracts, the IPSASB considered the requirements of IFRS 4. The election to treat financial guarantee contracts as financial instruments or insurance contracts under IFRS 4 is available only to those entities that previously explicitly asserted that they deem such contracts to be insurance contracts. The IPSASB, however, recognized that not all entities that have adopted accrual accounting apply IFRS 4. It acknowledged that it should also consider scenarios where, for example, entities applied accrual accounting but did not recognize assets and liabilities relating to insurance contracts, as well as entities that previously did not apply accrual accounting. Consequently, the IPSASB agreed that the existing requirements in IFRS 4 were too onerous and would need to be modified in the context of this Standard.

BC10. The IPSASB therefore agreed that entities that previously:

(a) Applied insurance accounting and adopted an accounting policy that treated financial guarantee contracts as insurance contracts, could continue to treat those guarantees as insurance contracts or as financial instruments; and

(b) Did not apply insurance accounting would be allowed a choice of treating financial guarantee contracts either as insurance contracts or financial instruments when they adopt this Standard.

In both instances, the election is irrevocable.

BC11. The IPSASB considered whether entities should be allowed to elect to treat financial guarantees as insurance contracts on a contract-by-contract basis or, whether entities should be required to make a general accounting policy choice. It was agreed that the choice should be made on an individual contract basis to allow entities within an economic entity to treat financial guarantees as insurance contracts or financial instruments, based on the nature of their businesses.

BC12. The IPSASB agreed, as a precondition for allowing entities to treat financial guarantees as insurance contracts, that the accounting practices applied by entities for insurance contracts should meet certain requirements. The IPSASB agreed that if entities elected to treat financial guarantee contracts as insurance contracts, that they must apply either IFRS 4 or a national accounting standard that requires insurance liabilities to be measured at a minimum value. That minimum value is determined as if the insurance liabilities were within the scope of IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* using the current estimates of cash flows arising from an entity's insurance contracts and of any related cash flows.

Option to Treat Insurance Contracts that Transfer Financial Risk as Financial Instruments

BC13. IPSAS 15 allowed entities to account for contracts that are insurance contracts that result in the transfer of financial risk, as financial instruments. In the absence of an IPSAS on insurance contracts, the IPSASB concluded that it should allow, but not require, entities to apply IPSAS 28 to such contracts.

Identifying Contractual Financial Guarantees

BC14. Financial instruments in IPSAS 28 are defined as: "…any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity." As arrangements in the public sector may arise through statutory powers, the IPSASB developed additional application guidance to identify when financial guarantees are contractual. The IPSASB concluded that, to be within the scope of IPSAS 28, financial guarantees should have the key features of a contractual arrangement. The IPSASB also concluded that an entity should distinguish the right to issue guarantees, which is often conferred on an entity through statutory or similar means, and the actual issuing of the guarantee in favour of a third party, irrespective of whether that party is explicitly or implicitly identified. A statutory right to issue guarantees, of itself, is not within the scope of this Standard.

Definitions

Contractual Arrangements

BC15. The IPSASB noted that, in certain jurisdictions, public sector entities are precluded from entering into formal contracts, but do enter into arrangements that have the substance of contracts. These arrangements may be known by another term, e.g., a "government order." To assist entities in identifying contracts, which either have the substance or legal form of a contract, the IPSASB considered it appropriate to issue additional Application Guidance explaining the factors an entity should consider in assessing whether an arrangement is contractual or non-contractual.

BC16. Consideration was given as to whether the term "binding arrangement" should be used to describe the arrangements highlighted in paragraph BC15. The term "binding arrangement" has not been defined, but has been used in IPSASs to describe arrangements that are binding on the parties, but do not take the form of a documented contract, such as an arrangement between two government departments that do not have the power to contract. The IPSASB concluded that the term "binding arrangements," as used in IPSASs, embraces a wider set of arrangements than those identified in paragraph BC15 and therefore concluded that it should not be used in this IPSAS.

Contractual Non-Exchange Revenue Transactions

BC17. IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* prescribes the initial recognition, initial measurement and disclosure of assets and liabilities arising out of non-exchange revenue transactions. The IPSASB considered the interaction between this Standard and IPSAS 23.

BC18. In considering whether assets and liabilities that arise from non-exchange revenue transactions are financial assets and financial liabilities, the IPSASB identified that the following basic requirements should be fulfilled:

- The arrangement is contractual in nature; and
- The arrangement gives rise to a contractual right or obligation to receive or deliver cash or another financial asset, or exchange financial assets under favorable or unfavorable conditions.

BC19. The IPSASB concluded that assets arising from non-exchange revenue transactions could meet these requirements. In particular, it noted that the nature of arrangements with donors may be contractual in nature, and may be settled by transferring cash or another financial asset from the donor to the recipient. In these instances, assets arising from non-exchange revenue transactions are financial assets.

BC20. The IPSASB agreed that, for financial assets arising from non-exchange transactions, an entity should apply the requirements of IPSAS 23 in conjunction with IPSAS 28. In particular, an entity considers the principles in IPSAS 28 in considering whether an inflow of resources from a non-exchange revenue transaction results in a liability or a transaction that evidences a residual interest in the net assets of the entity, i.e., an equity instrument.

BC21. The IPSASB considered whether liabilities arising from non-exchange revenue transactions are financial liabilities. Liabilities are recognized in IPSAS 23 when an entity receives an inflow of resources that is subject to specific conditions. Conditions on a transfer of resources are imposed on an entity by a transferor and require that the resources are used in a certain way, often to provide goods and services to third parties, or are returned to the transferor. This gives rise to an obligation to perform in terms of the agreement. At initial recognition, an entity recognizes the resources as an asset and, where they are subject to conditions, recognizes a corresponding liability.

BC22. The IPSASB considered whether the liability initially recognized is in the nature of a financial liability or another liability, e.g., a provision. The IPSASB agreed that, at the time the asset is recognized, the liability is not usually a financial liability as the entity's obligation is to fulfil the terms and conditions of the arrangement by utilizing the resources as intended, usually by providing goods and services to third parties over a period of time. If after initial recognition, the entity cannot the fulfil the terms of the arrangement and is required to return the resources to the transferor, an entity would assess at this stage whether the liability is a financial liability considering the requirements set out in paragraph BC18 and the definitions of a financial instrument and a financial liability. In rare circumstances, a financial liability may arise from conditions imposed on a transfer of resources as part of a non-exchange revenue transaction. The IPSASB may consider such a scenario as part of a future project.

BC23. The IPSASB also noted that other liabilities may arise from non-exchange revenue transactions after initial recognition. For example, an entity may receive resources under an arrangement that requires the resources to be returned only after the occurrence or non-occurrence of a future event. An entity assesses whether other liabilities arising from non-exchange revenue transactions are financial liabilities by considering whether the requirements in paragraph BC18 have been fulfilled and the definitions of a financial instrument and a financial liability have been met.

Other

Interpretations Developed by the International Financial Reporting Interpretations Committee

BC24. The IPSASB considered whether International Financial Reporting Interpretations Committee Interpretation (IFRIC) 2, *Members' Shares in Co-operative Entities and Similar Instruments* and International Financial Reporting Interpretations Committee Interpretation (IFRIC) 11, *IFRS 2—Group and Treasury Share Transactions* were relevant for the types of instruments entered into by governments and entities in the public sector.

BC25. When this Standard was issued, the IPSASB considered that IFRIC 11 is not relevant for the types of instruments entered into in the public sector as it deals with share-based payment transactions. While share-based payments may be common in [Government Business Enterprises (GBE's)] (the term in square brackets is no longer used following the issue of *The Applicability of IPSASs* in April 2016), they do not occur frequently in entities that are not GBE's. As a result, the IPSASB has not included any principles from IFRIC 11 in IPSAS 28.

BC26. IFRIC 2 provides guidance on the application of IAS 32 to members' shares in co-operative entities and similar instruments. There is a strong link between IAS 32 and IFRIC 2 in relation to puttable financial instruments and obligations arising on liquidation. As the text of IAS 32 that deals with puttable financial instruments and obligations arising on liquidation has been retained in IPSAS 28, IFRIC 2 provides additional guidance to users of IPSAS 28 in applying those principles to members' interests in co-operative entities. Therefore, the principles and examples from IFRIC 2 have been included in IPSAS 28 as an authoritative appendix.

Revision of IPSAS 28 as a result of IASB's *Improvements to IFRSs* issued in May 2012

BC27. The IPSASB reviewed the revisions to IAS 32 included in the *Improvements to IFRSs* issued by the IASB in May 2012 and generally concurred that there was no public sector specific reason for not adopting the amendments.

Revision of IPSAS 28 as a result of the IPSASB's *The Applicability of IPSASs*, issued in April 2016

BC28. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:

(a) Removes the standard paragraphs about the applicability of IPSASs to "public sector entities other than GBEs" from the scope section of each Standard;

(b) Replaces the term "GBE" with the term "commercial public sector entities", where appropriate; and

(c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 28.

Accounting for Contracts on Equity Instruments of an Entity

IE1. The following examples illustrate the application of paragraphs 13–32 and IPSAS 41 to the accounting for contracts on an entity's own equity instruments. In these examples, monetary amounts are denominated in "currency units" (CU).

Example 1: Forward to Buy Shares

IE2. This example illustrates the journal entries for forward purchase contracts on an entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below). To simplify the illustration, it is assumed that no dividends are paid on the underlying shares (i.e., the "carry return" is zero) so that the present value of the forward price equals the spot price when the fair value of the forward contract is zero. The fair value of the forward has been computed as the difference between the market share price and the present value of the fixed forward price.

Assumptions:

Contract date	February 1, 20X2
Maturity date	January 31, 20X3
Market price per share on February, 1 20X2	CU100
Market price per share on December, 31 20X2	CU110
Market price per share on January, 31 20X3	CU106
Fixed forward price to be paid on January, 31 20X3	CU104
Present value of forward price on February, 1 20X2	CU100
Number of shares under forward contract	1,000
Fair value of forward on February, 1 20X2	CU0
Fair value of forward on December, 31 20X2	CU6,300
Fair value of forward on January, 31 20X3	CU2,000

(a) **Cash for Cash ("Net Cash Settlement")**

IE3. In this subsection, the forward purchase contract on the entity's own shares will be settled net in cash, i.e., there is no receipt or delivery of the entity's own shares upon settlement of the forward contract.

On February 1, 20X2, Entity A enters into a contract with Entity B to receive the fair value of 1,000 of Entity A's own outstanding ordinary shares as of January 31, 20X3 in exchange for a payment of CU104,000 in cash (i.e., CU104 per share) on January 31, 20X3. The contract will be settled net in cash. Entity A records the following journal entries.

February 1, 20X2

The price per share when the contract is agreed on February 1, 20X2 is CU100. The initial fair value of the forward contract on February 1, 20X2 is zero.

No entry is required because the fair value of the derivative is zero and no cash is paid or received.

December 31, 20X2

On December 31, 20X2, the market price per share has increased to CU110 and, as a result, the fair value of the forward contract has increased to CU6,300.

Dr		Forward asset	CU6,300	
	Cr	Gain		CU6,300

To record the increase in the fair value of the forward contract.

January 31, 20X3

On January 31, 20X3, the market price per share has decreased to CU106. The fair value of the forward contract is CU2,000 ([CU106 × 1,000] – CU104,000).

On the same day, the contract is settled net in cash. Entity A has an obligation to deliver CU104,000 to Entity B and Entity B has an obligation to deliver CU106,000 (CU106 × 1,000) to Entity A, so Entity B pays the net amount of CU2,000 to Entity A.

Dr		Loss	CU4,300	
	Cr	Forward asset		CU4,300

To record the decrease in the fair value of the forward contract (i.e., CU4,300 = CU6,300 – CU2,000).

Dr		Cash	CU2,000	
	Cr	Forward asset		CU2,000

To record the settlement of the forward contract.

(b) **Shares for Shares ("Net Share Settlement")**

IE4. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as those shown in (a) above, except for recording the settlement of the forward contract, as follows:

January 31, 20X3

The contract is settled net in shares. Entity A has an obligation to deliver CU104,000 (CU104 × 1,000) worth of its shares to Entity B and Entity B has an obligation to deliver CU106,000 (CU106 × 1,000) worth of shares to Entity A. Thus, Entity B delivers a net amount of CU2,000 (CU106,000 – CU104,000) worth of shares to Entity A, i.e., 18.9 shares (CU2,000/CU106).

Dr		Net assets/equity	CU2,000	
	Cr	Forward asset		CU2,000

To record the settlement of the forward contract.

(c) **Cash for Shares ("Gross Physical Settlement")**

IE5. Assume the same facts as in (a) except that settlement will be made by delivering a fixed amount of cash and receiving a fixed number of Entity A's shares. Similarly to (a) and (b) above, the price per share that Entity A will pay in one year is fixed at CU104. Accordingly, Entity A has an obligation to pay CU104,000 in cash to Entity B (CU104 × 1,000) and Entity B has an obligation to deliver 1,000 of Entity A's outstanding shares to Entity A in one year. Entity A records the following journal entries.

February 1, 20X2

Dr		Net assets/equity	CU100,000	
	Cr	Liability		CU100,000

To record the obligation to deliver CU104,000 in one year at its present value of CU100,000 discounted using an appropriate interest rate (see IPSAS 41, paragraph AG115).

December 31, 20X2

Dr		Interest expense	CU3,660	
	Cr	Liability		CU3,660

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

January 31, 20X3

Dr		Interest expense	CU340	
	Cr	Liability		CU340

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

Entity A delivers CU104,000 in cash to Entity B and Entity B delivers 1,000 of Entity A's shares to Entity A.

Dr		Liability	CU104,000	
	Cr	Cash		CU104,000

To record the settlement of the obligation to redeem Entity A's own shares for cash.

(d) **Settlement Options**

IE6. The existence of settlement options (such as net in cash, net in shares, or by an exchange of cash and shares) has the result that the forward repurchase contract is a financial asset or a financial liability. If one of the settlement alternatives is to exchange cash for shares ((c) above), Entity A recognizes a liability for the obligation to deliver cash, as illustrated in (c) above. Otherwise, Entity A accounts for the forward contract as a derivative.

Example 2: Forward to Sell Shares

IE7. This example illustrates the journal entries for forward sale contracts on an entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by receiving cash in exchange for shares. It also discusses the effect of settlement options (see (d) below). To simplify the illustration, it is assumed that no dividends are paid on the underlying shares (i.e., the "carry return" is zero) so that the present value of the forward price equals the spot price when the fair value of the forward contract is zero. The fair value of the forward has been computed as the difference between the market share price and the present value of the fixed forward price.

Assumptions:	
Contract date	February 1, 20X2
Maturity date	January 31, 20X3
Market price per share on February 1, 20X2	CU100
Market price per share on December 31, 20X2	CU110
Market price per share on January 31, 20X3	CU106
Fixed forward price to be paid on January 31, 20X3	CU104
Present value of forward price on February 1, 20X2	CU100
Number of shares under forward contract	1,000
Fair value of forward on February 1, 20X2	CU0
Fair value of forward on December 31, 20X2	(CU6,300)
Fair value of forward on January 31, 20X3	(CU2,000)

(a) **Cash for Cash ("Net Cash Settlement")**

IE8. On February 1, 20X2, Entity A enters into a contract with Entity B to pay the fair value of 1,000 of Entity A's own outstanding ordinary shares as of January 31, 20X3 in exchange for CU104,000 in cash (i.e., CU104 per share) on January 31, 20X3. The contract will be settled net in cash. Entity A records the following journal entries.

February 1, 20X2

No entry is required because the fair value of the derivative is zero and no cash is paid or received.

December 31, 20X2

Dr		Loss	CU6,300	
	Cr	Forward liability		CU6,300

To record the decrease in the fair value of the forward contract.

January 31, 20X3

Dr	Forward liability	CU4,300	
Cr	Gain		CU4,300

To record the increase in the fair value of the forward contract (i.e., CU4,300 = CU6,300 – CU2,000).

The contract is settled net in cash. Entity B has an obligation to deliver CU104,000 to Entity A, and Entity A has an obligation to deliver CU106,000 (CU106 × 1,000) to Entity B. Thus, Entity A pays the net amount of CU2,000 to Entity B.

Dr	Forward liability	CU2,000	
Cr	Cash		CU2,000

To record the settlement of the forward contract.

(b) **Shares for Shares ("Net Share Settlement")**

IE9. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as those shown in (a), except:

January 31, 20X3

The contract is settled net in shares. Entity A has a right to receive CU104,000 (CU104 × 1,000) worth of its shares and an obligation to deliver CU106,000 (CU106 × 1,000) worth of its shares to Entity B. Thus, Entity A delivers a net amount of CU2,000 (CU106,000 – CU104,000) worth of its shares to Entity B, i.e., 18.9 shares (CU2,000/CU106).

Dr	Forward liability	CU2,000	
Cr	Net assets/equity		CU2,000

To record the settlement of the forward contract. The issue of the entity's own shares is treated as a transaction in net assets/equity.

(c) **Shares for Cash ("Gross Physical Settlement")**

IE10. Assume the same facts as in (a), except that settlement will be made by receiving a fixed amount of cash and delivering a fixed number of the entity's own shares. Similarly to (a) and (b) above, the price per share that Entity A will pay in one year is fixed at CU104. Accordingly, Entity A has a right to receive CU104,000 in cash (CU104 × 1,000) and an obligation to deliver 1,000 of its own shares in one year. Entity A records the following journal entries.

February 1, 20X2

No entry is made on February 1. No cash is paid or received because the forward has an initial fair value of zero. A forward contract to deliver a fixed number of Entity A's own shares in exchange for a fixed amount of cash or another financial asset meets the definition of an equity instrument because it cannot be settled otherwise than through the delivery of shares in exchange for cash.

December 31, 20X2

No entry is made on December 31, because no cash is paid or received and a contract to deliver a fixed number of Entity A's own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of the entity.

January 31, 20X3

On January 31, 20X3, Entity A receives CU104,000 in cash and delivers 1,000 shares.

Dr	Cash	CU104,000	
Cr	Net assets/equity		CU104,000

To record the settlement of the forward contract.

(d) **Settlement Options**

IE11. The existence of settlement options (such as net in cash, net in shares, or by an exchange of cash and shares) has the result that the forward contract is a financial asset or a financial liability. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A repurchasing a fixed number of its own shares in exchange for paying a fixed amount of cash or another financial asset. Entity A recognizes a derivative asset or liability, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

Example 3: Purchased Call Option on Shares

IE12. This example illustrates the journal entries for a purchased call option right on the entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by delivering cash in exchange for the entity's own shares. It also discusses the effect of settlement options (see (d) below):

Assumptions:	
Contract date	February 1, 20X2
Exercise date	January 31, 20X3
	(European terms, i.e., it can be exercised only at maturity)
Exercise right holder	Reporting entity (Entity A)
Market price per share on February 1, 20X2	CU100
Market price per share on December 31, 20X2	CU104
Market price per share on January 31, 20X3	CU104
Fixed exercise price to be paid on January 31, 20X3	CU102
Number of shares under option contract	1,000
Fair value of option on February 1, 20X2	CU5,000
Fair value of option on December 31, 20X2	CU3,000
Fair value of option on January 31, 20X3	CU2,000

(a) **Cash for Cash ("Net Cash Settlement")**

IE13. On February 1, 20X2, Entity A enters into a contract with Entity B that gives Entity B the obligation to deliver, and Entity A the right to receive the fair value of 1,000 of Entity A's own ordinary shares as of January 31, 20X3 in exchange for CU102,000 in cash (i.e., CU102 per share) on January 31, 20X3, if Entity A exercises that right. The contract will be settled net in cash. If Entity A does not exercise its right, no payment will be made. Entity A records the following journal entries.

February 1, 20X2

The price per share when the contract is agreed on February 1, 20X2 is CU100. The initial fair value of the option contract on February 1, 20X2 is CU5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of CU102 exceeds the market price per share of CU100 and it would therefore not be economic for Entity A to exercise the option. In other words, the call option is out of the money.

Dr		Call option asset	CU5,000	
	Cr	Cash		CU5,000

To recognize the purchased call option.

December 31, 20X2

On December 31, 20X2, the market price per share has increased to CU104. The fair value of the call option has decreased to CU3,000, of which CU2,000 is intrinsic value ([CU104 – CU102] × 1,000), and CU1,000 is the remaining time value.

Dr		Loss	CU2,000	
	Cr	Call option asset		CU2,000

To record the decrease in the fair value of the call option.

January 31, 20X3

On January 31, 20X3, the market price per share is still CU104. The fair value of the call option has decreased to CU2,000, which is all intrinsic value ([CU104 – CU102] × 1,000) because no time value remains.

Dr		Loss	CU1,000	
	Cr	Call option asset		CU1,000

To record the decrease in the fair value of the call option.

On the same day, Entity A exercises the call option and the contract is settled net in cash. Entity B has an obligation to deliver CU104,000 (CU104 × 1,000) to Entity A in exchange for CU102,000 (CU102 × 1,000) from Entity A, so Entity A receives a net amount of CU2,000.

Dr		Cash	CU2,000	
	Cr	Call option asset		CU2,000

To record the settlement of the option contract.

(b) Shares for Shares ("Net Share Settlement")

IE14. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as those shown in (a) except for recording the settlement of the option contract as follows:

January 31, 20X3

Entity A exercises the call option and the contract is settled net in shares. Entity B has an obligation to deliver CU104,000 (CU104 × 1,000) worth of Entity A's shares to Entity A in exchange for CU102,000 (CU102 × 1,000) worth of Entity A's shares. Thus, Entity B delivers the net amount of CU2,000 worth of shares to Entity A, i.e., 19.2 shares (CU2,000/CU104).

Dr		Net assets/equity	CU2,000	
	Cr	Call option asset		CU2,000

To record the settlement of the option contract. The settlement is accounted for as a treasury share transaction (i.e., no gain or loss).

(c) Cash for Shares ("Gross Physical Settlement")

IE15. Assume the same facts as in (a) except that settlement will be made by receiving a fixed number of shares and paying a fixed amount of cash, if Entity A exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU102. Accordingly, Entity A has a right to receive 1,000 of Entity A's own outstanding shares in exchange for CU102,000 (CU102 × 1,000) in cash, if Entity A exercises its option. Entity A records the following journal entries.

February 1, 20X2

Dr		Net assets/equity	CU5,000	
	Cr	Cash		CU5,000

To record the cash paid in exchange for the right to receive Entity A's own shares in one year for a fixed price. The premium paid is recognized in net assets/equity.

December 31, 20X2

No entry is made on December 31, because no cash is paid or received and a contract that gives a right to receive a fixed number of Entity A's own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of the entity.

January 31, 20X3

Entity A exercises the call option and the contract is settled gross. Entity B has an obligation to deliver 1,000 of Entity A's shares in exchange for CU102,000 in cash.

Dr		Net assets/equity	CU102,000	
	Cr	Cash		CU102,000

To record the settlement of the option contract.

(d) Settlement Options

IE16. The existence of settlement options (such as net in cash, net in shares, or by an exchange of cash and shares) has the result that the call option is a financial asset. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A repurchasing a fixed number of its own shares in exchange for paying a fixed amount of cash or another financial asset. Entity A recognizes a derivative asset, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

Example 4: Written Call Option on Shares

IE17. This example illustrates the journal entries for a written call option obligation on the entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below).

Assumptions*:*	
Contract date	February 1, 20X2
Exercise date	January 31, 20X3
	(European terms, i.e., it can be exercised only at maturity)
Exercise right holder	Counterparty (Entity B)
Market price per share on February 1, 20X2	CU100
Market price per share on December 31, 20X2	CU104
Market price per share on January 31, 20X3	CU104
Fixed exercise price to be paid on January 31, 20X3	CU102
Number of shares under option contract	1,000
Fair value of option on February 1, 20X2	CU5,000
Fair value of option on December 31, 20X2	CU3,000
Fair value of option on January 31, 20X3	CU2,000

(a) **Cash for Cash ("Net Cash Settlement")**

IE18. Assume the same facts as in Example 3(a) above except that Entity A has written a call option on its own shares instead of having purchased a call option on them. Accordingly, on February 1, 20X2 Entity A enters into a contract with Entity B that gives Entity B the right to receive and Entity A the obligation to pay the fair value of 1,000 of Entity A's own ordinary shares as of January 31, 20X3 in exchange for CU102,000 in cash (i.e., CU102 per share) on January 31, 20X3, if Entity B exercises that right. The contract will be settled net in cash. If Entity B does not exercise its right, no payment will be made. Entity A records the following journal entries.

February 1, 20X2

Dr		Cash	CU5,000	
	Cr	Call option obligation		CU5,000

To recognize the written call option.

December 31, 20X2

Dr		Call option obligation	CU2,000	
	Cr	Gain		CU2,000

To record the decrease in the fair value of the call option.

January 31, 20X3

Dr		Call option obligation	CU1,000	
	Cr	Gain		CU1,000

To record the decrease in the fair value of the option.

On the same day, Entity B exercises the call option and the contract is settled net in cash. Entity A has an obligation to deliver CU104,000 (CU104 × 1,000) to Entity B in exchange for CU102,000 (CU102 × 1,000) from Entity B, so Entity A pays a net amount of CU2,000.

Dr		Call option obligation	CU2,000	
	Cr	Cash		CU2,000

To record the settlement of the option contract.

(b) **Shares for Shares ("Net Share Settlement")**

IE19. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as those shown in (a), except for recording the settlement of the option contract, as follows:

December 31, 20X3

Entity B exercises the call option and the contract is settled net in shares. Entity A has an obligation to deliver CU104,000 (CU104 × 1,000) worth of Entity A's shares to Entity B in exchange for CU102,000 (CU102 × 1,000) worth of Entity A's shares. Thus, Entity A delivers the net amount of CU2,000 worth of shares to Entity B, i.e., 19.2 shares (CU2,000/CU104).

Dr		Call option obligation	CU2,000	
	Cr	Net assets/equity		CU2,000

To record the settlement of the option contract. The settlement is accounted for as a transaction in net assets/equity.

(c) **Cash for Shares ("Gross Physical Settlement")**

IE20. Assume the same facts as in (a) except that settlement will be made by delivering a fixed number of shares and receiving a fixed amount of cash, if Entity B exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU102. Accordingly, Entity B has a right to receive 1,000 of Entity A's own outstanding shares in exchange for CU102,000 (CU102 × 1,000) in cash, if Entity B exercises its option. Entity A records the following journal entries.

February 1, 20X2

Dr		Cash	CU5,000	
	Cr	Net assets/equity		CU5,000

To record the cash received in exchange for the obligation to deliver a fixed number of Entity A's own shares in one year for a fixed price. The premium received is recognized in net assets/equity. Upon exercise, the call would result in the issue of a fixed number of shares in exchange for a fixed amount of cash.

December 31, 20X2

No entry is made on December 31 because no cash is paid or received and a contract to deliver a fixed number of Entity A's own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of the entity.

January 31, 20X3

Entity B exercises the call option and the contract is settled gross. Entity A has an obligation to deliver 1,000 shares in exchange for CU102,000 in cash.

Dr		Cash	CU102,000	
	Cr	Net assets/equity		CU102,000

To record the settlement of the option contract.

(d) **Settlement Options**

IE21. The existence of settlement options (such as net in cash, net in shares, or by an exchange of cash and shares) has the result that the call option is a financial liability. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A issuing a fixed number of its own shares in exchange for receiving a fixed amount of cash or another financial asset. Entity A recognizes a derivative liability, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

Example 5: Purchased Put Option on Shares

IE22. This example illustrates the journal entries for a purchased put option on the entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below).

Assumptions:	
Contract date	February 1, 20X2
Exercise date	January 31, 20X3
	(European terms, i.e., it can be exercised only at maturity)
Exercise right holder	Reporting entity (Entity A)

Assumptions:	
Market price per share on February 1, 20X2	CU100
Market price per share on December 31, 20X2	CU95
Market price per share on January 31, 20X3	CU95
Fixed exercise price to be paid on January 31, 20X3	CU98
Number of shares under option contract	1,000
Fair value of option on February 1, 20X2	CU5,000
Fair value of option on December 31, 20X2	CU4,000
Fair value of option on January 31, 20X3	CU3,000

(a) **Cash for Cash ("Net Cash Settlement")**

IE23. On February 1, 20X2, Entity A enters into a contract with Entity B that gives Entity A the right to sell, and Entity B the obligation to buy the fair value of 1,000 of Entity A's own outstanding ordinary shares as of January 31, 20X3 at a strike price of CU98,000 (i.e., CU98 per share) on January 31, 20X3, if Entity A exercises that right. The contract will be settled net in cash. If Entity A does not exercise its right, no payment will be made. Entity A records the following journal entries.

February, 1 20X2

The price per share when the contract is agreed on February 1, 20X2 is CU100. The initial fair value of the option contract on February 1, 20X2 is CU5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of CU98 is less than the market price per share of CU100. Therefore it would not be economic for Entity A to exercise the option. In other words, the put option is out of the money.

Dr		Put option asset	CU5,000	
	Cr	Cash		CU5,000

To recognize the purchased put option.

December 31, 20X2

On December 31, 20X2 the market price per share has decreased to CU95. The fair value of the put option has decreased to CU4,000, of which CU3,000 is intrinsic value ([CU98 – CU95] × 1,000) and CU1,000 is the remaining time value.

Dr		Loss	CU1,000	
	Cr	Put option asset		CU1,000

To record the decrease in the fair value of the put option.

January 31, 20X3

On January 31, 20X3 the market price per share is still CU95. The fair value of the put option has decreased to CU3,000, which is all intrinsic value ([CU98 – CU95] × 1,000) because no time value remains.

Dr		Loss	CU1,000	
	Cr	Put option asset		CU1,000

To record the decrease in the fair value of the option.

On the same day, Entity A exercises the put option and the contract is settled net in cash. Entity B has an obligation to deliver CU98,000 to Entity A and Entity A has an obligation to deliver CU95,000 (CU95 × 1,000) to Entity B, so Entity B pays the net amount of CU3,000 to Entity A.

Dr		Cash	CU3,000	
	Cr	Put option asset		CU3,000

To record the settlement of the option contract.

(b) **Shares for Shares ("Net Share Settlement")**

IE24. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as shown in (a), except:

January 31, 20X3

Entity A exercises the put option and the contract is settled net in shares. In effect, Entity B has an obligation to deliver CU98,000 worth of Entity A's shares to Entity A, and Entity A has an obligation to deliver CU95,000 worth of Entity A's shares (CU95 × 1,000) to Entity B, so Entity B delivers the net amount of CU3,000 worth of shares to Entity A, i.e., 31.6 shares (CU3,000/CU95).

Dr		Net assets/equity	CU3,000	
	Cr	Put option asset		CU3,000

To record the settlement of the option contract.

(c) **Cash for Shares ("Gross Physical Settlement")**

IE25. Assume the same facts as in (a) except that settlement will be made by receiving a fixed amount of cash and delivering a fixed number of Entity A's shares, if Entity A exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU98. Accordingly, Entity B has an obligation to pay CU98,000 in cash to Entity A (CU98 × 1,000) in exchange for 1,000 of Entity A's outstanding shares, if Entity A exercises its option. Entity A records the following journal entries.

February 1, 20X2

Dr		Net assets/equity	CU5,000	
	Cr	Cash		CU5,000

To record the cash received in exchange for the right to deliver Entity A's own shares in one year for a fixed price. The premium paid is recognized directly in net assets/equity. Upon exercise, it results in the issue of a fixed number of shares in exchange for a fixed price.

December 31, 20X2

No entry is made on December 31, because no cash is paid or received and a contract to deliver a fixed number of Entity A's own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of Entity A.

January 31, 20X3

Entity A exercises the put option and the contract is settled gross. Entity B has an obligation to deliver CU98,000 in cash to Entity A in exchange for 1,000 shares.

Dr		Cash	CU98,000	
	Cr	Net assets/equity		CU98,000

To record the settlement of the option contract.

(d) **Settlement Options**

IE26. The existence of settlement options (such as net in cash, net in shares, or by an exchange of cash and shares) has the result that the put option is a financial asset. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A issuing a fixed number of its own shares in exchange for receiving a fixed amount of cash or another financial asset. Entity A recognizes a derivative asset, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

Example 6: Written Put Option on Shares

IE27. This example illustrates the journal entries for a written put option on the entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below).

Assumptions*:*

Contract date	February 1, 20X2
Exercise date	January 31, 20X3 (European terms, i.e., it can be exercised only at maturity)
Exercise right holder	Counterparty (Entity B)

Assumptions:

Market price per share on February 1, 20X2	CU100
Market price per share on December 31, 20X2	CU95
Market price per share on January 31, 20X3	CU95
Fixed exercise price to be paid on January 31, 20X3	CU98
Present value of exercise price on February 1, 20X2	CU95
Number of shares under option contract	1,000
Fair value of option on February 1, 20X2	CU5,000
Fair value of option on December 31, 20X2	CU4,000
Fair value of option on January 31, 20X3	CU3,000

(a) **Cash for Cash ("Net Cash Settlement")**

IE28. Assume the same facts as in Example 5(a) above, except that Entity A has written a put option on its own shares instead of having purchased a put option on its own shares. Accordingly, on February, 1 20X2, Entity A enters into a contract with Entity B that gives Entity B the right to receive and Entity A the obligation to pay the fair value of 1,000 of Entity A's outstanding ordinary shares as of January 31, 20X3 in exchange for CU98,000 in cash (i.e., CU98 per share) on January 31, 20X3, if Entity B exercises that right. The contract will be settled net in cash. If Entity B does not exercise its right, no payment will be made. Entity A records the following journal entries.

February 1, 20X2

Dr		Cash	CU5,000	
	Cr	Put option liability		CU5,000

To recognize the written put option.

December 31, 20X2

Dr		Put option liability	CU1,000	
	Cr	Gain		CU1,000

To record the decrease in the fair value of the put option.

January 31, 20X3

Dr		Put option liability	CU1,000	
	Cr	Gain		CU1,000

To record the decrease in the fair value of the put option.

On the same day, Entity B exercises the put option and the contract is settled net in cash. Entity A has an obligation to deliver CU98,000 to Entity B, and Entity B has an obligation to deliver CU95,000 (CU95 × 1,000) to Entity A. Thus, Entity A pays the net amount of CU3,000 to Entity B.

Dr		Put option liability	CU3,000	
	Cr	Cash		CU3,000

To record the settlement of the option contract.

(b) **Shares for Shares ("Net Share Settlement")**

IE29. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as those in (a), except for the following:

January 31, 20X3

Entity B exercises the put option and the contract is settled net in shares. In effect, Entity A has an obligation to deliver CU98,000 worth of shares to Entity B, and Entity B has an obligation to deliver CU95,000 worth of Entity A's shares

(CU95 × 1,000) to Entity A. Thus, Entity A delivers the net amount of CU3,000 worth of Entity A's shares to Entity B, i.e., 31.6 shares (3,000/95).

Dr		Put option liability	CU3,000	
	Cr	Net assets/equity		CU3,000

To record the settlement of the option contract. The issue of Entity A's own shares is accounted for as a transaction in net assets/equity.

(c) **Cash for Shares ("Gross Physical Settlement")**

IE30. Assume the same facts as in (a) except that settlement will be made by delivering a fixed amount of cash and receiving a fixed number of shares, if Entity B exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU98. Accordingly, Entity A has an obligation to pay CU98,000 in cash to Entity B (CU98 × 1,000) in exchange for 1,000 of Entity A's outstanding shares, if Entity B exercises its option. Entity A records the following journal entries.

February 1, 20X2

Dr		Cash	CU5,000	
	Cr	Net assets/equity		CU5,000

To recognize the option premium received of CU5,000 in net assets/equity.

Dr		Net assets/equity	CU95,000	
	Cr	Liability		CU95,000

To recognize the present value of the obligation to deliver CU98,000 in one year, i.e., CU95,000, as a liability.

December 31, 20X2

Dr		Interest expense	CU2,750	
	Cr	Liability		CU2,750

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

January 31, 20X3

Dr		Interest expense	CU250	
	Cr	Liability		CU250

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

On the same day, Entity B exercises the put option and the contract is settled gross. Entity A has an obligation to deliver CU98,000 in cash to Entity B in exchange for CU95,000 worth of shares (CU95 × 1,000).

Dr		Liability	CU98,000	
	Cr	Cash		CU98,000

To record the settlement of the option contract.

(d) **Settlement Options**

IE31. The existence of settlement options (such as net in cash, net in shares, or by an exchange of cash and shares) has the result that the written put option is a financial liability. If one of the settlement alternatives is to exchange cash for shares ((c) above), Entity A recognizes a liability for the obligation to deliver cash, as illustrated in (c) above. Otherwise, Entity A accounts for the put option as a derivative liability.

Entities such as Mutual Funds and Co-operatives Whose Share Capital is not Net Assets/Equity

Example 7: Entities with No Net Assets/Equity

IE32. The following example illustrates a format of a statement of financial performance and statement of financial position that may be used by entities such as mutual funds that do not have net assets/equity. Other formats are possible.

Statement of Financial Performance for the year ended December 31, 20X1

	20X1	20X0
	CU	CU
Revenue	2,956	1,718
Total Revenue	2,956	1,718
Expenses (classified by nature or function)	(644)	(614)
Finance costs		
– other finance costs	(47)	(47)
– distributions to unitholders	(50)	(50)
Total Expenses	(741)	(711)
Surplus for the year	2,215	1,007
Change in net assets attributable to unitholders	2,215	1,007

Statement of Financial Position at December 31, 20X1

		20X1		20X0
	CU	CU	CU	CU
ASSETS				
Non-current assets (classified in accordance with IPSAS 1)	91,374		78,484	
Total non-current assets		91,374		78,484
Current assets (classified in accordance with IPSAS 1)	1,422		1,769	
Total current assets		1,422		1,769
Total assets		92,796		80,253
LIABILITIES				
Current liabilities (classified in accordance with IPSAS 1)	647		66	
Total current liabilities		(647)		(66)
Non-current liabilities excluding net assets attributable to unitholders (classified in accordance with IPSAS 1)	280		136	
		(280)		(136)
Net assets attributable to unitholders		91,869		80,051

Example 8: Entities with Some Net Assets/Equity

IE33. The following example illustrates a format of a statement of financial performance and statement of financial position that may be used by entities whose share capital is not net assets/equity because the entity has an obligation to repay the share capital on demand. Other formats are possible.

Statement of Financial Performance for the year ended December 31, 20X1

	20X1	20X0
	CU	CU
Revenue	472	498
Total Revenue	472	498
Expenses (classified by nature or function)	(367)	(396)
Finance costs		
– other finance costs	(4)	(4)

Statement of Financial Performance for the year ended December 31, 20X1

– distributions to members	(50)	(50)
Total Expenses	(421)	(450)
Surplus for the year	51	48
Change in net assets attributable to members	51	48

Statement of Financial Position at December 31, 20X1

		20X1		20X0
	CU	CU	CU	CU
ASSETS				
Non-current assets (classified in accordance with IPSAS 1)	908		830	
Total non-current assets		908		830
Current assets (classified in accordance with IPSAS 1)	383		350	
Total current assets		383		350
Total assets		1,291		1,180
LIABILITIES				
Current liabilities (classified in accordance with IPSAS 1)	372		338	
Share capital repayable on demand	202		161	
Total current liabilities		(574)		(499)
Total assets less current liabilities		717		681
Non-current liabilities (classified in accordance with IPSAS 1)	187		196	
		(187)		(196)
OTHER COMPONENTS OF NET ASSETS/EQUITY[(a)]				
Reserves, e.g., revaluation surplus, accumulated surplus, etc.	530		485	
		530		485
		717		681

Statement of Financial Position at December 31, 20X1		
MEMORANDUM NOTE – Total members' interests		
Share capital repayable on demand	202	161
Reserves	530	485
	732	646

(a) In this example, the entity has no obligation to deliver a share of its reserves to its members.

Accounting for Compound Financial Instruments

Example 9: Separation of a Compound Financial Instrument on Initial Recognition

IE34. Paragraph 33 describes how the components of a compound financial instrument are separated by the entity on initial recognition. The following example illustrates how such a separation is made.

IE35. An entity issues 2,000 convertible bonds at the start of year 1. The bonds have a three-year term, and are issued at par with a face value of CU1,000 per bond, giving total proceeds of CU2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 percent. Each bond is convertible at any time up to maturity into 250 ordinary shares. When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9 percent.

IE36. The liability component is measured first, and the difference between the proceeds of the bond issue and the fair value of the liability is assigned to the net assets/equity component. The present value of the liability component is calculated using a discount rate of 9 percent, the market interest rate for similar bonds having no conversion rights, as shown below.

	CU
Present value of the principal – CU2,000,000 payable at the end of three years	1,544,367
Present value of the interest – CU120,000 payable annually in arrears for three years	303,755
Total liability component	1,848,122
Net assets/equity component (by deduction)	151,878
Proceeds of the bond issue	2,000,000

Example 10: Separation of a Compound Financial Instrument with Multiple Embedded Derivative Features

IE37. The following example illustrates the application of paragraph 36 to the separation of a compound financial instrument with multiple embedded derivative features into the liability and net assets/equity component.

IE38. Assume that the proceeds received on the issue of a callable convertible bond are CU60. The value of a similar bond without a call or equity conversion option is CU57. Based on an option pricing model, it is determined that the value to the entity of the embedded call feature in a similar bond without an equity conversion option is CU2. In this case, the value allocated to the liability component under paragraph 36 is CU55 (CU57 – CU2) and the value allocated to the net assets/equity component is CU5 (CU60 – CU55).

Example 11: Repurchase of a Convertible Instrument

IE39. The following example illustrates how an entity accounts for a repurchase of a convertible instrument. For simplicity, at inception, the face amount of the instrument is assumed to be equal to the aggregate carrying amount of the liability and the net assets/equity components in the financial statements, i.e., no original issue premium or discount exists. Also, for simplicity, tax considerations have been omitted from the example.

IE40. On January 1, 20X0, Entity A issued a 10 percent convertible debenture with a face value of CU1,000 maturing on December 31, 20X9. The debenture is convertible into ordinary shares of Entity A at a conversion price of CU25 per share. Interest is payable half-yearly in cash. At the date of issue, Entity A could have issued non-convertible debt with a ten-year term bearing a coupon interest rate of 11 percent.

IE41. In the financial statements of Entity A the carrying amount of the debenture was allocated on issue as follows:

	CU
Liability component	
Present value of 20 half-yearly interest payments of CU50, discounted at 11%	597
Present value of CU1,000 due in 10 years, discounted at 11%, compounded half-yearly	343
	940
Net assets/equity component	
(difference between CU1,000 total proceeds and CU940 allocated above)	60
Total proceeds	1,000

IE42. On January 1, 20X5 the convertible debenture has a fair value of CU1,700.

IE43. Entity A makes a tender offer to the holder of the debenture to repurchase the debenture for CU1,700, which the holder accepts. At the date of repurchase, Entity A could have issued non-convertible debt with a five-year term bearing a coupon interest rate of 8 percent.

IE44. The repurchase price is allocated as follows:

	Carrying value	**Fair value**	**Difference**
Liability component:	CU	CU	CU
Present value of 10 remaining half-yearly interest payments of CU50, discounted at 11% and 8%, respectively	377	405	
Present value of CU1,000 due in 5 years, discounted at 11% and 8%, compounded half-yearly, respectively	585	676	
	962	1,081	(119)
Net assets/equity component	60	619[(a)]	(559)
Total	1,022	1,700	(678)

(a) This amount represents the difference between the fair value amount allocated to the liability component and the repurchase price of CU1,700.

IE45. Entity A recognizes the repurchase of the debenture as follows:

Dr		Liability component	CU962	
Dr		Debt settlement expense (surplus or deficit)	CU119	
	Cr	Cash		CU1,081

To recognize the repurchase of the liability component.

Dr		Net assets/equity	CU619	
	Cr	Cash		CU619

To recognize the cash paid for the net assets/equity component.

IE46. The net assets/equity component remains as net assets/equity, but may be transferred from one line item within net assets/equity to another.

Example 12: Amendment of the Terms of a Convertible Instrument to Induce Early Conversion

IE47. The following example illustrates how an entity accounts for the additional consideration paid when the terms of a convertible instrument are amended to induce early conversion.

IE48. On January 1, 20X0, Entity A issued a 10 percent convertible debenture with a face value of CU1,000 with the same terms as described in Example 9. On January 1, 20X1, to induce the holder to convert the convertible debenture promptly, Entity A reduces the conversion price to CU20 if the debenture is converted before March 1, 20X1 (i.e., within 60 days).

IE49. Assume the market price of Entity A's ordinary shares on the date the terms are amended is CU40 per share. The fair value of the incremental consideration paid by Entity A is calculated as follows:

Number of ordinary shares to be issued to debenture holders under *amended* conversion terms:		
Face amount	CU1,000	
New conversion price	/CU20	per share
Number of ordinary shares to be issued on conversion	50	shares
Number of ordinary shares to be issued to debenture holders under **original** *conversion terms:*		
Face amount	CU1,000	
Original conversion price	/CU25	per share
Number of ordinary shares to be issued on conversion	40	Shares
Number of incremental ordinary shares issued upon conversion	10	Shares
Value of **incremental** *ordinary shares issued upon conversion*		
CU40 per share x 10 incremental shares	CU400	

IE50. The incremental consideration of CU400 is recognized as a loss in surplus or deficit.

Comparison with IAS 32

IPSAS 28, *Financial Instruments: Presentation* is drawn primarily from IAS 32, *Financial Instruments: Presentation* (issued originally in 2003, including amendments up to December 31, 2008). The main differences between IPSAS 28 and IAS 32 are as follows:

- IAS 32 allows entities to treat financial guarantee contracts as insurance contracts where entities have previously asserted that such contracts are insurance contracts. IPSAS 28 allows a similar election, except that entities need not have explicitly asserted that financial guarantees are insurance contracts.
- In certain instances, IPSAS 28 uses different terminology from IAS 32. The most significant examples are the use of the terms "statement of financial performance" and "net assets/equity." The equivalent terms in IAS 32 are "statement of comprehensive income or separate income statement (if presented)" and "equity."
- IPSAS 28 does not distinguish between "revenue" and "income." IAS 32 distinguishes between "revenue" and "income," with "income" having a broader meaning than the term "revenue."
- IPSAS 28 contains additional Application Guidance dealing with the identification of arrangements that are, in substance, contractual.
- IPSAS 28 contains additional Application Guidance on when assets and liabilities arising from non-exchange revenue transactions are financial assets or financial liabilities.
- Principles from IFRIC 2, *Members' Shares in Co-operative Entities and Similar Instruments* have been included as an Appendix in IPSAS 28.
- The transitional provisions in IPSAS 28 differ from those in IAS 32. This is because IPSAS 28 provides transitional provisions for those entities applying this Standard for the first time or those applying accrual accounting for the first time.

IPSAS 29—FINANCIAL INSTRUMENTS:RECOGNITION AND MEASUREMENT

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 39, *Financial Instruments: Recognition and Measurement*, International Financial Reporting Interpretations Committee (IFRIC) Interpretation 9, *Reassessment of Embedded Derivatives*, (IFRIC 9) and Interpretation 16 (IFRIC 16) of the IFRIC, *Hedges of a Net Investment in a Foreign Operation* published by the International Accounting Standards Board (IASB). Extracts from IAS 39, IFRIC 9, and IFRIC 16 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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IPSAS 29—FINANCIAL INSTRUMENTS:RECOGNITION AND MEASUREMENT

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 29, *Financial Instruments: Recognition and Measurement* was issued in January 2010.

Since then, IPSAS 29 has been amended by the following IPSASs:

- IPSAS 43, *Leases* (issued January 2022)
- *Improvements to IPSAS 2021* (issued January 2022)
- *COVID-19: Deferral of Effective Dates* (issued November 2020)
- IPSAS 41, *Financial Instruments* (issued August 2018)
- IPSAS 40, *Public Sector Combinations* (issued January 2017)
- IPSAS 39, *Employee Benefits* (issued July 2016)
- *The Applicability of IPSASs* (issued April 2016)
- *Improvements to IPSASs 2015* (issued April 2016)
- IPSAS 37, *Joint Arrangements* (issued January 2015)
- IPSAS 35, *Consolidated Financial Statements* (issued January 2015)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- IPSAS 32, *Service Concession Arrangements: Grantor* (issued October 2011)
- *Improvements to IPSASs 2011* (issued October 2011)

Table of Amended Paragraphs in IPSAS 29

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
1	Deleted	IPSAS 41 August 2018
2	Amended	IPSAS 40 January 2017 IPSAS 39 July 2016 IPSAS 37 January 2015 IPSAS 35 January 2015 IPSAS 32 October 2011 IPSAS 41 August 2018
3	Deleted	IPSAS 41 August 2018
4	Deleted	IPSAS 41 August 2018
5	Deleted	IPSAS 41 August 2018
6	Deleted	IPSAS 41 August 2018
7	Deleted	The Applicability of IPSASs April 2016
8	Deleted	The Applicability of IPSASs April 2016
9	Amended	IPSAS 41 August 2018
10	Amended	IPSAS 41 August 2018
11–79	Deleted	IPSAS 41 August 2018
80	Amended	IPSAS 41 August 2018

Paragraph Affected	How Affected	Affected By
88	Deleted	IPSAS 41 August 2018
89	Amended	IPSAS 35 January 2015
98	Amended	IPSAS 41 August 2018
99	Amended	IPSAS 41 August 2018
101	Amended	IPSAS 41 August 2018
102	Amended	IPSAS 41 August 2018
107	Amended	IPSAS 41 August 2018
108	Amended	IPSAS 41 August 2018
109	Amended	IPSAS 41 August 2018
111	Amended	IPSAS 41 August 2018
112	Amended	IPSAS 41 August 2018
113	Amended	IPSAS 41 August 2018
Heading above paragraph 113A	New	Improvements to IPSAS January 2022
113A	New	Improvements to IPSAS January 2022
113B	New	Improvements to IPSAS January 2022
113C	New	Improvements to IPSAS January 2022
Heading above paragraph 113D	New	Improvements to IPSAS January 2022
113D	New	Improvements to IPSAS January 2022
Heading above paragraph 113E	New	Improvements to IPSAS January 2022
113E	New	Improvements to IPSAS January 2022
Heading above paragraph 113F	New	Improvements to IPSAS January 2022
113F	New	Improvements to IPSAS January 2022
113G	New	Improvements to IPSAS January 2022
Heading above paragraph 113H	New	Improvements to IPSAS January 2022
113H	New	Improvements to IPSAS January 2022
113I	New	Improvements to IPSAS January 2022
Heading above paragraph 113J	New	Improvements to IPSAS January 2022
113J	New	Improvements to IPSAS January 2022
113K	New	Improvements to IPSAS January 2022
113L	New	Improvements to IPSAS January 2022
113M	New	Improvements to IPSAS January 2022
113N	New	Improvements to IPSAS January 2022
113O	New	Improvements to IPSAS January 2022
113P	New	Improvements to IPSAS January 2022
113Q	New	Improvements to IPSAS January 2022
113R	New	Improvements to IPSAS January 2022
113S	New	Improvements to IPSAS January 2022
113T	New	Improvements to IPSAS January 2022
113U	New	Improvements to IPSAS January 2022
Headings above paragraph 113V	New	Improvements to IPSAS January 2022
113V	New	Improvements to IPSAS January 2022

Paragraph Affected	How Affected	Affected By
Heading above paragraph 113W	New	Improvements to IPSAS January 2022
113W	New	Improvements to IPSAS January 2022
113X	New	Improvements to IPSAS January 2022
Heading above paragraph 113Y	New	Improvements to IPSAS January 2022
113Y	New	Improvements to IPSAS January 2022
113Z	New	Improvements to IPSAS January 2022
Heading above paragraph 113ZA	New	Improvements to IPSAS January 2022
113ZA	New	Improvements to IPSAS January 2022
113ZB	New	Improvements to IPSAS January 2022
113ZC	New	Improvements to IPSAS January 2022
114	Deleted	IPSAS 33 January 2015
115	Deleted	IPSAS 33 January 2015
116	Deleted	IPSAS 33 January 2015
117	Deleted	IPSAS 33 January 2015
118	Deleted	IPSAS 33 January 2015
119	Deleted	IPSAS 33 January 2015
120	Deleted	IPSAS 33 January 2015
121	Deleted	IPSAS 33 January 2015
122	Deleted	IPSAS 33 January 2015
123	Deleted	IPSAS 33 January 2015
125A	Amended	IPSAS 32 October 2011 IPSAS 43 January 2022
125B	New	IPSAS 33 January 2015
125C	New	IPSAS 37 January 2015 IPSAS 35 January 2015
125D	New	Improvements to IPSASs April 2016
125E	New	The Applicability of IPSASs April 2016
125F	New	IPSAS 39 July 2016
125G	New	IPSAS 40 January 2017
125H	Amended	COVID-19: Deferral of Effective Dates November 2020
125I	New	Improvements to IPSAS January 2022
125J	New	Improvements to IPSAS January 2022
125K	New	Improvements to IPSAS January 2022
125L	New	Improvements to IPSAS January 2022
125M	New	Improvements to IPSAS January 2022
126	Amended	IPSAS 33 January 2015
AG35	Amended	IPSAS 40 January 2017
AG51	Amended	IPSAS 35 January 2015
AG52	Amended	IPSAS 35 January 2015
AG53	Amended	IPSAS 35 January 2015

Paragraph Affected	How Affected	Affected By
AG1–AG126	Deleted	IPSAS 41 August 2018
AG128	Amended	IPSAS 41 August 2018
AG129	Deleted	IPSAS 41 August 2018
AG131	Amended	IPSAS 40 January 2017
AG134	Amended	IPSAS 41 August 2018
AG156A	New	IPSAS 41 August 2018
AG157	Amended	IPSAS 41 August 2018
AG161	Amended	IPSAS 41 August 2018
B1–B7	Deleted	IPSAS 41 August 2018
C2	Amended	IPSAS 37 January 2015
A.1–G.2	Deleted	IPSAS 41 August 2018
BC21	New	Improvements to IPSAS January 2022
BC22	New	Improvements to IPSAS January 2022
BC23	New	Improvements to IPSAS January 2022
BC24	New	Improvements to IPSAS January 2022
IE32–IE50	Deleted	IPSAS 41 August 2018

IPSAS 29—FINANCIAL INSTRUMENTS:RECOGNITION AND MEASUREMENT

CONTENTS

International Public Sector Accounting Standard 29, *Financial Instruments: Recognition and Measurement*, is set out in paragraphs 1–126. All the paragraphs have equal authority. IPSAS 29 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. [Deleted]

Scope

3. **This Standard shall be applied by all entities to all financial instruments within the scope of IPSAS 41, *Financial Instruments* if, and to the extent that:**

   (a) **IPSAS 41 permits the hedge accounting requirements of this Standard to be applied; and**

   (c) **The financial instrument is part of a hedging relationship that qualifies for hedge accounting in accordance with this Standard.**

3–8 [Deleted]

6.

7.

8.

9.

10.

11.

Definitions

18. The terms defined in IPSAS 28 and IPSAS 41 are used in this Standard with the meanings specified in paragraph 9 of IPSAS 28 and paragraph 9 of IPSAS 41. IPSAS 28 and IPSAS 41 define the following terms:

- Amortized cost of a financial asset or financial liability;
- Derecognition;
- Derivative;
- Effective interest method;
- Effective interest rate;
- Equity instrument;
- Financial asset;
- Financial instrument;
- Financial liability;
- Firm commitment;
- Forecast transaction;

and provides guidance on applying those definitions.

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

Definitions relating to hedge accounting

A <u>hedging instrument</u> is a designated derivative or (for a hedge of the risk of changes in foreign currency exchange rates only) a designated non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item (paragraphs 81–86 and Appendix A paragraphs AG127–AG130 elaborate on the definition of a hedging instrument).

A <u>hedged item</u> is an asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation that (a) exposes the entity to risk of changes in fair value or future cash flows and (b) is designated as being hedged (paragraphs 87–94 and Appendix A paragraphs AG131–AG141 elaborate on the definition of hedged items).

Hedge effectiveness is the degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument (see Appendix A paragraphs AG145–AG156).

Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.

11–79. [Deleted]

Hedging

80. **If an entity applies IPSAS 41 and has not chosen as its accounting policy to continue to apply the hedge accounting requirements of this Standard (see paragraph 177 of IPSAS 41), it shall apply the hedge accounting requirements in paragraphs 113–155 of IPSAS 41. However, for a fair value hedge of the interest rate exposure of a portion of a portfolio of financial assets or financial liabilities, an entity may, in accordance with paragraph 115 of IPSAS 41,**

Hedging Instruments

Qualifying Instruments

81. This Standard does not restrict the circumstances in which a derivative may be designated as a hedging instrument provided the conditions in paragraph 98 are met, except for some written options (see Appendix A paragraph AG127). However, a non-derivative financial asset or non-derivative financial liability may be designated as a hedging instrument only for a hedge of a foreign currency risk.

82. For hedge accounting purposes, only instruments that involve a party external to the reporting entity (i.e., external to the economic entity or individual entity that is being reported on) can be designated as hedging instruments. Although individual entities within an economic entity or divisions within an entity may enter into hedging transactions with other entities within the economic entity or divisions within the entity, any such transactions within the economic entity are eliminated on consolidation. Therefore, such hedging transactions do not qualify for hedge accounting in the consolidated financial statements of the economic entity. However, they may qualify for hedge accounting in the individual or separate financial statements of individual entities within the economic entity provided that they are external to the individual entity that is being reported on.

Designation of Hedging Instruments

83. There is normally a single fair value measure for a hedging instrument in its entirety, and the factors that cause changes in fair value are co-dependent. Thus, a hedging relationship is designated by an entity for a hedging instrument in its entirety. The only exceptions permitted are:

(a) Separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the change in intrinsic value of an option and excluding change in its time value; and

(b) Separating the interest element and the spot price of a forward contract.

These exceptions are permitted because the intrinsic value of the option and the premium on the forward can generally be measured separately. A dynamic hedging strategy that assesses both the intrinsic value and time value of an option contract can qualify for hedge accounting.

84. A proportion of the entire hedging instrument, such as 50 percent of the notional amount, may be designated as the hedging instrument in a hedging relationship. However, a hedging relationship may not be designated for only a portion of the time period during which a hedging instrument remains outstanding.

85. A single hedging instrument may be designated as a hedge of more than one type of risk provided that (a) the risks hedged can be identified clearly; (b) the effectiveness of the hedge can be demonstrated; and (c) it is possible to ensure that there is specific designation of the hedging instrument and different risk positions.

86. Two or more derivatives, or proportions of them (or, in the case of a hedge of currency risk, two or more non-derivatives or proportions of them, or a combination of derivatives and non-derivatives or proportions of them), may be viewed in combination and jointly designated as the hedging instrument, including when the risk(s) arising from some derivatives offset(s) those arising from others. However, an interest rate collar or other derivative instrument that combines a written option and a purchased option does not qualify as a hedging instrument if it is, in effect, a net written option (for which a net premium is received). Similarly, two or more instruments (or proportions of them) may be designated as the hedging instrument only if none of them

unrecognized firm commitment, a highly probable forecast transaction or a net investment in a foreign operation. The hedged item can be (a) a single asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation, (b) a group of assets, liabilities, firm commitments, highly probable forecast transactions or net investments in foreign operations with similar risk characteristics, or (c) in a portfolio hedge of interest rate risk only, a portion of the portfolio of financial assets or financial liabilities that share the risk being hedged.

88. [Deleted]

89. For hedge accounting purposes, only assets, liabilities, firm commitments or highly probable forecast transactions that involve a party external to the entity can be designated as hedged items. It follows that hedge accounting can be applied to transactions between entities in the same economic entity only in the individual or separate financial statements of those entities and not in the consolidated financial statements of the economic entity except for the consolidated financial statements of an investment entity, as defined in IPSAS 35, where transactions between an investment entity and its controlled entities measured at fair value through surplus or deficit will not be eliminated in the consolidated financial statements. As an exception, the foreign currency risk of monetary item within an economic entity (e.g., a payable/receivable between two controlled entities) may qualify as a hedged item in the consolidated financial statements if it results in an exposure to foreign exchange rate gains or losses that are not fully eliminated on consolidation in accordance with IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*. In accordance with IPSAS 4, foreign exchange rate gains and losses on monetary items within an economic entity are not fully eliminated on consolidation when the monetary item is transacted between two entities within the economic entity that have different functional currencies. In addition, the foreign currency risk of a highly probable forecast transaction within the economic entity may qualify as a hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated surplus or deficit.

Designation of Financial Items as Hedged Items

90. If the hedged item is a financial asset or financial liability, it may be a hedged item with respect to the risks associated with only a portion of its cash flows or fair value (such as one or more selected contractual cash flows or portions of them or a percentage of the fair value) provided that effectiveness can be measured. For example, an identifiable and separately measurable portion of the interest rate exposure of an interest-bearing asset or interest-bearing liability may be designated as the hedged risk (such as a risk-free interest rate or benchmark interest rate component of the total interest rate exposure of a hedged financial instrument).

91. In a fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities (and only in such a hedge), the portion hedged may be designated in terms of an amount of a currency (e.g., an amount of dollars, euro, pounds or rand) rather than as individual assets (or liabilities). Although the portfolio may, for risk management purposes, include assets and liabilities, the amount designated is an amount of assets or an amount of liabilities. Designation of a net amount including assets and liabilities is not permitted. The entity may hedge a portion of the interest rate risk associated with this designated amount. For example, in the case of a hedge of a portfolio containing prepayable assets, the entity may hedge the change in fair value that is attributable to a change in the hedged interest rate on the basis of expected, rather than contractual, repricing dates. When the portion hedged is based on expected repricing dates, the effect that changes in the hedged interest rate have on those expected repricing dates shall be included when determining the change in the fair value of the hedged item. Consequently, if a portfolio that contains prepayable items is hedged with a non-prepayable derivative, ineffectiveness arises if the dates on which items in the hedged portfolio are expected to prepay are revised, or actual prepayment dates differ from those expected.

Designation of Non-Financial Items as Hedged Items

92. **If the hedged item is a non-financial asset or non-financial liability, it shall be designated as a hedged item (a) for foreign currency risks, or (b) in its entirety for all risks, because of the difficulty of isolating and measuring the appropriate portion of the cash flows or fair value changes attributable to specific risks other than foreign currency risks.**

Designation of Groups of Items as Hedged Items

93. Similar assets or similar liabilities shall be aggregated and hedged as a group only if the individual assets or individual liabilities in the group share the risk exposure that is designated as being hedged. Furthermore, the change in fair value attributable to the hedged risk for each individual item in the group shall be expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group of items.

94. Because an entity assesses hedge effectiveness by comparing the change in the fair value or cash flow of a hedging instrument (or group of similar hedging instruments) and a hedged item (or group of similar hedged items), comparing a hedging instrument with an overall net position (e.g., the net of all fixed rate assets and fixed rate liabilities with similar maturities), rather than with a specific hedged item, does not qualify for hedge accounting.

Hedge Accounting

95. Hedge accounting recognizes the offsetting effects on surplus or deficit of changes in the fair values of the hedging instrument and the hedged item.

96. **Hedging relationships are of three types:**

(a) **Fair value hedge: a hedge of the exposure to changes in fair value of a recognized asset or liability or an unrecognized firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect surplus or deficit.**

(b) **Cash flow hedge: a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognized asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect surplus or deficit.**

(c) **Hedge of a net investment in a foreign operation as defined in IPSAS 4.**

97. A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value hedge or as a cash flow hedge.

98. **A hedging relationship qualifies for hedge accounting under paragraphs 99–113 if, and only if, all of the following conditions are met.**

(a) **At the inception of the hedge there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk.**

(b) **The hedge is expected to be highly effective (see Appendix A paragraphs AG145–AG156) in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship.**

(c) **For cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect surplus or deficit.**

(d) **The effectiveness of the hedge can be reliably measured, i.e., the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured.**

(f) **The hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated.**

Fair Value Hedges

99. **If a fair value hedge meets the conditions in paragraph 98 during the period, it shall be accounted for as follows:**

(a) **The gain or loss from remeasuring the hedging instrument at fair value (for a derivative hedging instrument) or the foreign currency component of its carrying amount measured in accordance with IPSAS 4 (for a non-derivative hedging instrument) shall be recognized in surplus or deficit; and**

(b) **The gain or loss on the hedged item attributable to the hedged risk shall adjust the carrying amount of the hedged item and be recognized in surplus or deficit. This applies if the hedged item is otherwise measured at cost. Recognition of the gain or loss attributable to the hedged risk in surplus or deficit applies if the hedged item is a financial asset measured at fair value through net assets/equity in accordance with paragraph 41 of IPSAS 41.**

100. For a fair value hedge of the interest rate exposure of a portion of a portfolio of financial assets or financial liabilities (and only in such a hedge), the requirement in paragraph 99(b) may be met by presenting the gain or loss attributable to the hedged item either:

(a) In a single separate line item within assets, for those repricing time periods for which the hedged item is an asset; or

(b) In a single separate line item within liabilities, for those repricing time periods for which the hedged item is a liability.

The separate line items referred to in (a) and (b) above shall be presented next to financial assets or financial liabilities. Amounts included in these line items shall be removed from the statement of financial position when the assets or liabilities to which they relate are derecognized.

101. If only particular risks attributable to a hedged item are hedged, recognized changes in the fair value of the hedged item unrelated to the hedged risk are recognized as set out in paragraph 101 of IPSAS 41.

102. **An entity shall discontinue prospectively the hedge accounting specified in paragraph 99 if:**

(a) **The hedging instrument expires or is sold, terminated or exercised. For this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging strategy. Additionally, for this purpose there is not an expiration or termination of the hedging instrument if:**

(i) **As a consequence of laws or regulations or the introduction of laws or regulations, the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties. For this purpose, a clearing counterparty is a central counterparty (sometimes called a 'clearing organization' or 'clearing agency') or an entity or entities, for example, a clearing member of a clearing organization or a client of a clearing member of a clearing organization, that are acting as counterparty in order to effect clearing by a central counterparty. However, when the parties to the hedging instrument replace their original counterparties with different counterparties this paragraph shall apply only if each of those parties effects clearing with the same central counterparty.**

(ii) **Other changes, if any, to the hedging instrument are limited to those that are necessary to effect such a replacement of the counterparty. Such changes are limited to those that are consistent with the terms that would be expected if the hedging instrument were originally cleared with the clearing counterparty. These changes include changes in the collateral requirements, rights to offset receivables and payables balances, and charges levied.**

(b) **The hedge no longer meets the criteria for hedge accounting in paragraph 98; or**

(c) **The entity revokes the designation.**

103. **Any adjustment arising from paragraph 99(b) to the carrying amount of a hedged financial instrument for which the effective interest method is used (or, in the case of a portfolio hedge of interest rate risk, to the separate line item in the statement of financial position described in paragraph 100) shall be amortized to surplus or deficit. Amortization may begin as soon as an adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged. The adjustment is based on a recalculated effective interest rate at the date amortization begins. However, if, in the case of a fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities (and only in such a hedge), amortizing using a recalculated effective interest rate is not practicable, the adjustment shall be amortized using a straight-line method. The adjustment shall be amortized fully by maturity of the financial instrument or, in the case of a portfolio hedge of interest rate risk, by expiry of the relevant repricing time period.**

104. When an unrecognized firm commitment is designated as a hedged item, the subsequent cumulative change in the fair value of the firm commitment attributable to the hedged risk is recognized as an asset or liability with a corresponding gain or loss recognized in surplus or deficit (see paragraph 99(b)). The changes in the fair value of the hedging instrument are also recognized in surplus or deficit.

105. When an entity enters into a firm commitment to acquire an asset or assume a liability that is a hedged item in a fair value hedge, the initial carrying amount of the asset or liability that results from the entity meeting the firm commitment is adjusted to include the cumulative change in the fair value of the firm commitment attributable to the hedged risk that was recognized in the statement of financial position.

Cash Flow Hedges

106. **If a cash flow hedge meets the conditions in paragraph 98 during the period, it shall be accounted for as follows:**

(a) **The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (see paragraph 98) shall be recognized directly in net assets/equity through the statement of changes in net assets/equity; and**

(b) **The ineffective portion of the gain or loss on the hedging instrument shall be recognized in surplus or deficit.**

107. More specifically, a cash flow hedge is accounted for as follows:

(a) The separate component of net assets/equity associated with the hedged item is adjusted to the lesser of the following (in absolute amounts):

(i) The cumulative gain or loss on the hedging instrument from inception of the hedge; and

(ii) The cumulative change in fair value (present value) of the expected future cash flows on the hedged item from inception of the hedge;

(b) Any remaining gain or loss on the hedging instrument or designated component of it (that is not an effective hedge) is recognized in surplus or deficit; and

(c) If an entity's documented risk management strategy for a particular hedging relationship excludes from the assessment of hedge effectiveness a specific component of the gain or loss or related cash flows on the hedging instrument (see paragraphs 83, 84, and 98(a)), that excluded component of gain or loss is recognized in accordance with paragraph 101 of IPSAS 41.

108. **If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gains or losses that were recognized directly in net assets/equity in accordance with paragraph 106 shall be reclassified into surplus or deficit as a reclassification adjustment in the same period or periods during which the hedged forecast cash flows affects surplus or deficit (such as in the periods that interest revenue or interest expense is recognized). However, if an entity expects that all or a portion of a loss recognized directly in net assets/equity will not be recovered in one or more future periods, it shall reclassify into surplus or deficit as a reclassification adjustment the amount that is not expected to be recovered.**

109. **If a hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or a non-financial liability, or a forecast transaction for a non-financial asset or non-financial liability becomes a firm commitment for which fair value hedge accounting is applied, then the entity shall adopt (a) or (b) below:**

(a) **It reclassifies the associated gains and losses that were recognized directly in net assets/equity in accordance with paragraph 106 into surplus or deficit as a reclassification adjustment in the same period or periods during which the asset acquired or liability assumed affects surplus or deficit (such as in the periods that depreciation or inventories are recognized as an expense). However, if an entity expects that all or a portion of a loss recognized directly in net assets/equity will not be recovered in one or more future periods, it shall reclassify from net assets/equity into surplus or deficit as a reclassification adjustment the amount that is not expected to be recovered.**

(b) **It removes the associated gains and losses that were recognized directly in net assets/equity in accordance with paragraph 106, and includes them in the initial cost or other carrying amount of the asset or liability.**

110. **An entity shall adopt either (a) or (b) in paragraph 109 as its accounting policy and shall apply it consistently to all hedges to which paragraph 109 relates.**

111. **For cash flow hedges other than those covered by paragraphs 108 and 109, amounts that had been recognized directly in net assets/equity shall be recognized in surplus or deficit as a reclassification adjustment in the same period or periods during which the hedged forecast cash flows affects surplus or deficit (e.g., when a forecast sale occurs).**

112. **In any of the following circumstances an entity shall discontinue prospectively the hedge accounting specified in paragraphs 106–111:**

(a) **The hedging instrument expires or is sold, terminated or exercised. In this case, the cumulative gain or loss on the hedging instrument that remains recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall remain separately recognized in net assets/equity until the forecast transaction occurs. When the transaction occurs, paragraph 108, 109, or 111 applies. For the purpose of this subparagraph, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging strategy. Additionally, for the purpose of this subparagraph there is not an expiration or termination of the hedging instrument if:**

(i) **As a consequence of laws or regulations or the introduction of laws or regulations, the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty**

to become the new counterparty to each of the parties. For this purpose, a clearing counterparty is a central counterparty (sometimes called a 'clearing organization' or 'clearing agency') or an entity or entities, for example, a clearing member of a clearing organization or a client of a clearing member of a clearing organization, that are acting as counterparty in order to effect clearing by a central counterparty. However, when the parties to the hedging instrument replace their original counterparties with different counterparties this paragraph shall apply only if each of those parties effects clearing with the same central counterparty.

(ii) **Other changes, if any, to the hedging instrument are limited to those that are necessary to effect such a replacement of the counterparty. Such changes are limited to those that are consistent with the terms that would be expected if the hedging instrument were originally cleared with the clearing counterparty. These changes include changes in the collateral requirements, rights to offset receivables and payables balances, and charges levied.**

(b) **The hedge no longer meets the criteria for hedge accounting in paragraph 98. In this case, the cumulative gain or loss on the hedging instrument that remains recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall remain separately recognized in net assets/equity until the forecast transaction occurs. When the transaction occurs, paragraph 108, 109, or 111 applies.**

(c) **The forecast transaction is no longer expected to occur, in which case any related cumulative gain or loss on the hedging instrument that has been recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall be recognized in surplus or deficit as a reclassification adjustment. A forecast transaction that is no longer highly probable (see paragraph 98(c)) may still be expected to occur.**

(d) **The entity revokes the designation. For hedges of a forecast transaction, the cumulative gain or loss on the hedging instrument that remains recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall remain separately recognized in net assets/equity until the forecast transaction occurs or is no longer expected to occur. When the transaction occurs, paragraph 108, 109, or 111 applies. If the transaction is no longer expected to occur, the cumulative gain or loss that had been recognized directly in net assets/equity shall be recognized in surplus or deficit as a reclassification adjustment.**

Hedges of a Net Investment

113. **Hedges of a net investment in a foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment (see IPSAS 4), shall be accounted for similarly to cash flow hedges:**

(a) **The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (see paragraph 98) shall be recognized directly in net assets/equity through the statement of changes in net assets/equity (see IPSAS 1); and**

(b) **The ineffective portion shall be recognized in surplus or deficit.**

The gain or loss on the hedging instrument relating to the effective portion of the hedge that has been recognized directly in net assets/equity shall be recognized in surplus or deficit as a reclassification adjustment in accordance with paragraphs 56–57 of IPSAS 4 on disposal of the foreign operation.

Temporary Exceptions from Applying Specific Hedge Accounting Requirements

113A. An entity shall apply paragraphs 113D–113N and 125I to all hedging relationships directly affected by interest rate benchmark reform. These paragraphs apply only to such hedging relationships. A hedging relationship is directly affected by interest rate benchmark reform only if the reform gives rise to uncertainties about:

(a) The interest rate benchmark (contractually or non-contractually specified) designated as a hedged risk; and/or

(b) The timing or the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument.

113B. For the purpose of applying paragraphs 113D–113N, the term 'interest rate benchmark reform' refers to the market-wide reform of an interest rate benchmark, including the replacement of an interest rate benchmark with an alternative benchmark rate such as that resulting from the recommendations set out in the Financial Stability Board's July 2014 report 'Reforming Major Interest Rate Benchmarks'.[1]

[1] The report, 'Reforming Major Interest Rate Benchmarks', is available at http://www.fsb.org/wp-content/uploads/r_140722.pdf.

113C. Paragraphs 113D–113N provide exceptions only to the requirements specified in these paragraphs. An entity shall continue to apply all other hedge accounting requirements to hedging relationships directly affected by interest rate benchmark reform.

Highly Probable Requirement for Cash Flow Hedges

113D. For the purpose of applying the requirement in paragraph 98(c) that a forecast transaction must be highly probable, an entity shall assume that the interest rate benchmark on which the hedged cash flows (contractually or non-contractually specified) are based is not altered as a result of interest rate benchmark reform.

Reclassifying the Cumulative Gain or Loss Recognized in Net Assets/Equity

113E. For the purpose of applying the requirement in paragraph 112(c) in order to determine whether the forecast transaction is no longer expected to occur, an entity shall assume that the interest rate benchmark on which the hedged cash flows (contractually or non-contractually specified) are based is not altered as a result of interest rate benchmark reform.

Effectiveness Assessment

113F. For the purpose of applying the requirements in paragraphs 98(b) and AG145(a), an entity shall assume that the interest rate benchmark on which the hedged cash flows and/or the hedged risk (contractually or non-contractually specified) are based, or the interest rate benchmark on which the cash flows of the hedging instrument are based, is not altered as a result of interest rate benchmark reform.

113G. For the purpose of applying the requirement in paragraph 98(e), an entity is not required to discontinue a hedging relationship because the actual results of the hedge do not meet the requirements in paragraph AG145(b). For the avoidance of doubt, an entity shall apply the other conditions in paragraph 98, including the prospective assessment in paragraph 98(b), to assess whether the hedging relationship must be discontinued.

Designating Financial Items as Hedged Items

113H. Unless paragraph 113I applies, for a hedge of a non-contractually specified benchmark portion of interest rate risk, an entity shall apply the requirement in paragraphs 90 and AG139—that the designated portion shall be separately identifiable—only at the inception of the hedging relationship.

113I. When an entity, consistent with its hedge documentation, frequently resets (i.e., discontinues and restarts) a hedging relationship because both the hedging instrument and the hedged item frequently change (i.e., the entity uses a dynamic process in which both the hedged items and the hedging instruments used to manage that exposure do not remain the same for long), the entity shall apply the requirement in paragraphs 90 and AG139—that the designated portion is separately identifiable—only when it initially designates a hedged item in that hedging relationship. A hedged item that has been assessed at the time of its initial designation in the hedging relationship, whether it was at the time of the hedge inception or subsequently, is not reassessed at any subsequent redesignation in the same hedging relationship.

End of Application

113J. An entity shall prospectively cease applying paragraph 113D to a hedged item at the earlier of:

(a) When the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows of the hedged item; and

(b) When the hedging relationship that the hedged item is part of is discontinued.

113K. An entity shall prospectively cease applying paragraph 113E at the earlier of:

(a) When the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based future cash flows of the hedged item; and

(b) When the entire cumulative gain or loss recognized in net assets/equity with respect to that discontinued hedging relationship has been reclassified to surplus or deficit.

113L. An entity shall prospectively cease applying paragraph 113F:

(a) To a hedged item, when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk or the timing and the amount of the interest rate benchmark-based cash flows of the hedged item; and

(b) To a hedging instrument, when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows of the hedging instrument.

If the hedging relationship that the hedged item and the hedging instrument are part of is discontinued earlier than the date specified in paragraph 113L(a) or the date specified in paragraph 113L(b), the entity shall prospectively cease applying paragraph 113F to that hedging relationship at the date of discontinuation.

113M. An entity shall prospectively cease applying paragraph 113G to a hedging relationship at the earlier of:

(a) When the uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk and the timing and the amount of the interest rate benchmark-based cash flows of the hedged item and of the hedging instrument; and

(b) When the hedging relationship to which the exception is applied is discontinued.

113N. When designating a group of items as the hedged item, or a combination of financial instruments as the hedging instrument, an entity shall prospectively cease applying paragraphs 113D–113G to an individual item or financial instrument in accordance with paragraphs 113J, 113K, 113L, or 113M, as relevant, when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk and/or the timing and the amount of the interest rate benchmark-based cash flows of that item or financial instrument.

113O. An entity shall prospectively cease applying paragraphs 113H and 113I at the earlier of:

(a) When changes required by interest rate benchmark reform are made to the non-contractually specified risk portion applying paragraph 113P; or

(b) When the hedging relationship in which the non-contractually specified risk portion is designated is discontinued.

Additional Temporary Exceptions Arising from Interest Rate Benchmark Reform

Hedge Accounting

113P. As and when the requirements in paragraphs 113D–113I cease to apply to a hedging relationship (see paragraphs 113J–113O), an entity shall amend the formal designation of that hedging relationship as previously documented to reflect the changes required by interest rate benchmark reform, i.e., the changes are consistent with the requirements in paragraphs 72B–72D of IPSAS 41. In this context, the hedge designation shall be amended only to make one or more of these changes:

(a) Designating an alternative benchmark rate (contractually or non-contractually specified) as a hedged risk;

(b) Amending the description of the hedged item, including the description of the designated portion of the cash flows or fair value being hedged;

(c) Amending the description of the hedging instrument; or

(d) Amending the description of how the entity will assess hedge effectiveness.

113Q. An entity also shall apply the requirement in paragraph 113P(c) if these three conditions are met:

(a) The entity makes a change required by interest rate benchmark reform using an approach other than changing the basis for determining the contractual cash flows of the hedging instrument (as described in paragraph 72B of IPSAS 41);

(b) The original hedging instrument is not derecognized; and

(c) The chosen approach is economically equivalent to changing the basis for determining the contractual cash flows of the original hedging instrument (as described in paragraphs 72C and 72D of IPSAS 41).

113R. The requirements in paragraphs 113D–113I may cease to apply at different times. Therefore, applying paragraph 113P, an entity may be required to amend the formal designation of its hedging relationships at different times, or may be required to amend the formal designation of a hedging relationship more than once. When, and only when, such a change is made to the hedge designation, an entity shall apply paragraphs 113V–113ZB as applicable. An entity also shall apply paragraph 99 (for a fair value hedge) or paragraph 107 (for a cash flow hedge) to account for any changes in the fair value of the hedged item or the hedging instrument.

113S. An entity shall amend a hedging relationship as required in paragraph 113P by the end of the reporting period during which a change required by interest rate benchmark reform is made to the hedged risk, hedged item or hedging instrument. For the avoidance of doubt, such an amendment to the formal designation of a hedging relationship constitutes neither the discontinuation of the hedging relationship nor the designation of a new hedging relationship.

113T. If changes are made in addition to those changes required by interest rate benchmark reform to the financial asset or financial liability designated in a hedging relationship (as described in paragraphs 72B–72D of IPSAS 41) or to the designation of the hedging relationship (as required by paragraph 113P), an entity shall first apply the applicable requirements in this Standard to determine if those additional changes result in the discontinuation of hedge accounting. If the additional changes do not result in the discontinuation of hedge accounting, an entity shall amend the formal designation of the hedging relationship as specified in paragraph 113P.

113U. Paragraphs 113V–113ZC provide exceptions to the requirements specified in those paragraphs only. An entity shall apply all other hedge accounting requirements in this Standard, including the qualifying criteria in paragraph 98, to hedging relationships that were directly affected by interest rate benchmark reform.

Accounting for Qualifying Hedging Relationships

Retrospective Effectiveness Assessment

113V. For the purpose of assessing the retrospective effectiveness of a hedging relationship on a cumulative basis applying paragraph 98(e) and only for this purpose, an entity may elect to reset to zero the cumulative fair value changes of the hedged item and hedging instrument when ceasing to apply paragraph 113G as required by paragraph 113M. This election is made separately for each hedging relationship (i.e., on an individual hedging relationship basis).

Cash Flow Hedges

113W. For the purpose of applying paragraph 108, at the point when an entity amends the description of a hedged item as required in paragraph 113P(b), the cumulative gain or loss in net assets/equity shall be deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined.

113X. For a discontinued hedging relationship, when the interest rate benchmark on which the hedged future cash flows had been based is changed as required by interest rate benchmark reform, for the purpose of applying paragraph 112(c) in order to determine whether the hedged future cash flows are expected to occur, the amount accumulated in net assets/equity for that hedging relationship shall be deemed to be based on the alternative benchmark rate on which the hedged future cash flows will be based.

Groups of Items

113Y. When an entity applies paragraph 113P to groups of items designated as hedged items in a fair value or cash flow hedge, the entity shall allocate the hedged items to subgroups based on the benchmark rate being hedged and designate the benchmark rate as the hedged risk for each subgroup. For example, in a hedging relationship in which a group of items is hedged for changes in an interest rate benchmark subject to interest rate benchmark reform, the hedged cash flows or fair value of some items in the group could be changed to reference an alternative benchmark rate before other items in the group are changed. In this example, in applying paragraph 113P, the entity would designate the alternative benchmark rate as the hedged risk for that relevant subgroup of hedged items. The entity would continue to designate the existing interest rate benchmark as the hedged risk for the other subgroup of hedged items until the hedged cash flows or fair value of those items are changed to reference the alternative benchmark rate or the items expire and are replaced with hedged items that reference the alternative benchmark rate.

113Z. An entity shall assess separately whether each subgroup meets the requirements in paragraphs 87 and 93 to be an eligible hedged item. If any subgroup fails to meet the requirements in paragraphs 87 and 93, the entity shall discontinue hedge accounting prospectively for the hedging relationship in its entirety. An entity also shall apply the requirements in paragraphs 99 or 107 to account for ineffectiveness related to the hedging relationship in its entirety.

Designating Financial Items as Hedged Items

113ZA. An alternative benchmark rate designated as a non-contractually specified risk portion that is not separately identifiable (see paragraphs 90 and AG139) at the date it is designated shall be deemed to have met that requirement at that date, if, and only if, the entity reasonably expects the alternative benchmark rate will be separately identifiable within 24 months. The 24-month period applies to each alternative benchmark rate separately and starts from the date the entity designates the alternative benchmark rate as a non-contractually specified risk portion for the first time (i.e., the 24-month period applies on a rate-by-rate basis).

113ZB. If subsequently an entity reasonably expects that the alternative benchmark rate will not be separately identifiable within 24 months from the date the entity designated it as a non-contractually specified risk portion for the first time, the entity shall cease applying the requirement in paragraph 113ZA to that alternative benchmark rate and discontinue hedge accounting prospectively from the date of that reassessment for all hedging relationships in which the alternative benchmark rate was designated as a non-contractually specified risk portion.

113ZC. In addition to those hedging relationships specified in paragraph 113P, an entity shall apply the requirements in paragraphs 113ZA and 113ZB to new hedging relationships in which an alternative benchmark rate is designated as a non-contractually specified risk portion (see paragraphs 90 and AG139) when, because of interest rate benchmark reform, that risk portion is not separately identifiable at the date it is designated.

Transition

114. [Deleted]

115. [Deleted]

116. [Deleted]

117. [Deleted]

118. [Deleted]

119. [Deleted]

120. [Deleted]

121. [Deleted]

122. [Deleted]

123. [Deleted]

Effective Date and Transition

124. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2013. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2013, it shall disclose that fact.**

125. **An entity shall not apply this Standard before January 1, 2013, unless it also applies IPSAS 28 and IPSAS 30.**

125A. **Paragraph 2 was amended by IPSAS 32, *Service Concession Arrangements: Grantor* issued in October 2011. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2014, it shall disclose that fact and at the same time apply IPSAS 32, the amendments to paragraphs 6 and 42A of IPSAS 5, the amendments to paragraphs 5, 7 and 107C of IPSAS 17 and the amendments to paragraphs 6 and 132A of IPSAS 31.**

125B. **Paragraphs 114, 115, 116, 117, 118, 119, 120, 121, 122, 124 and 126 were amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

125C. **IPSAS 35, *Consolidated Financial Statements* and IPSAS 37, *Joint Arrangements*, issued in January 2015, amended paragraphs 2(a), 17, 89, AG2, AG14, AG51–53 and C2. An entity shall apply those amendments when it applies IPSAS 35 and IPSAS 37.**

125D. **Paragraph AG8 was amended by *Improvements to IPSASs 2015* issued in April 2016. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2017 it shall disclose that fact.**

125E. **Paragraphs 7 and 8 were deleted by *The Applicability of IPSASs*, issued in April 2016. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2018, it shall disclose that fact.**

125F. **Paragraph 2 was amended by IPSAS 39, *Employee Benefits*, issued in July 2016. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2018 it shall disclose that fact and apply IPSAS 39 at the same time.**

125G. **Paragraphs 2, AG35, AG131 and B4 were amended by IPSAS 40, *Public Sector Combinations*, issued in January 2017. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2019. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2019 it shall disclose that fact and apply IPSAS 40 at the same time.**

125H. **Paragraphs 2, 9, 10, 80, 98, 99, 101, 102, 107, 108, 109, 111, 112, 113, AG128, AG157 and AG161 were amended, paragraph AG156A was added and paragraphs 1, 3, 4, 5, 6, 11–79, 88, AG1–AG126 and AG129 were deleted by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply IPSAS 41 at the same time.**

125I. **Paragraphs 113A–113N were added by *Improvements to IPSAS, 2021*, issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact. An entity shall apply these amendments retrospectively to those hedging relationships that existed at the beginning of the reporting period in which an entity first applies these amendments or were designated thereafter, and to the gain or loss recognized in net assets/equity that existed at the beginning of the reporting period in which an entity first applies these amendments.**

125J. **Paragraphs 113O–113ZC, 125K–125M were added by *Improvements to IPSAS, 2021*, issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact. An entity shall apply these amendments retrospectively in accordance with IPSAS 3, except as specified in paragraphs 125K–125M.**

125K. An entity shall designate a new hedging relationship (for example, as described in paragraph 113ZC) only prospectively (i.e., an entity is prohibited from designating a new hedge accounting relationship in prior periods). However, an entity shall reinstate a discontinued hedging relationship if, and only if, these conditions are met:

(a) The entity had discontinued that hedging relationship solely due to changes required by interest rate benchmark reform and the entity would not have been required to discontinue that hedging relationship if these amendments had been applied at that time; and

(b) At the beginning of the reporting period in which an entity first applies these amendments (date of initial application of these amendments), that discontinued hedging relationship meets the qualifying criteria for hedge accounting (after taking into account these amendments).

125L. If, in applying paragraph 125K, an entity reinstates a discontinued hedging relationship, the entity shall read references in paragraphs 113ZA and 113ZB to the date the alternative benchmark rate is designated as a non-contractually specified risk portion for the first time as referring to the date of initial application of these amendments (i.e., the 24-month period for that alternative benchmark rate designated as a non-contractually specified risk portion begins from the date of initial application of these amendments).

125M. An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognize any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application of these amendments in the opening net assets/equity (or other component of net assets/equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.

126. When an entity adopts the accrual basis IPSASs of accounting as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 29.

Scope (paragraphs 2–8)

AG1–AG126. [Deleted]

Hedging (paragraphs 80–113)

Hedging Instruments (paragraphs 81–86)

Qualifying Instruments (paragraphs 81 and 82)

AG127. The potential loss on an option that an entity writes could be significantly greater than the potential gain in value of a related hedged item. In other words, a written option is not effective in reducing the surplus or deficit exposure of a hedged item. Therefore, a written option does not qualify as a hedging instrument unless it is designated as an offset to a purchased option, including one that is embedded in another financial instrument (e.g., a written call option used to hedge a callable liability). In contrast, a purchased option has potential gains equal to or greater than losses and therefore has the potential to reduce surplus or deficit exposure from changes in fair values or cash flows. Accordingly, it can qualify as a hedging instrument.

AG128. A financial asset measured at amortized cost may be designated as a hedging instrument in a hedge of foreign currency risk.

AG130. [Deleted]

AG132. An entity's own equity instruments are not financial assets or financial liabilities of the entity and therefore cannot be designated as hedging instruments.

Hedged items (paragraphs 87–94)

Qualifying items (paragraphs 87–89)

AG133. A firm commitment to acquire an entity or an integrated set of activities in a public sector combination cannot be a hedged item, except for foreign exchange risk, because the other risks being hedged cannot be specifically identified and measured. These other risks are general operational risks.

AG134. An equity method investment cannot be a hedged item in a fair value hedge because the equity method recognizes in surplus or deficit the investor's share of the associate's surplus or deficit, rather than changes in the investment's fair value. For a similar reason, an investment in a consolidated controlled entity cannot be a hedged item in a fair value hedge because consolidation recognizes in surplus or deficit the controlled entity's surplus or deficit, rather than changes in the investment's fair value. A hedge of a net investment in a foreign operation is different because it is a hedge of the foreign currency exposure, not a fair value hedge of the change in the value of the investment.

AG135. Paragraph 89 states that in consolidated financial statements the foreign currency risk of a highly probable forecast transaction within the economic entity may qualify as a hedged item in a cash flow hedge, provided the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated surplus or deficit. For this purpose an entity can be a controlling entity, controlled entity, associate, joint venture or branch. If the foreign currency risk of a forecast transaction within the economic entity does not affect consolidated surplus or deficit, the transaction cannot qualify as a hedged item. This is usually the case for royalty payments, interest payments or management charges between members of the same economic entity unless there is a related external transaction. However, when the foreign currency risk of a forecast transaction within the economic entity will affect consolidated surplus or deficit, the transaction can qualify as a hedged item. An example is forecast sales or purchases of inventories between members of the same economic entity if there is an onward sale of the inventory to a party external to the economic entity. Similarly, a forecast sale of property, plant and equipment within the economic entity from the entity that constructed it to the entity that will use the property, plant and equipment in its operations may affect consolidated surplus or deficit. This could occur, for example, because the plant and equipment will be depreciated by the purchasing entity and the amount initially recognized for the plant and equipment may change if the forecast transaction within the economic entity is denominated in a currency other than the functional currency of the purchasing entity.

AG136. If a hedge of a forecast transaction within the economic entity qualifies for hedge accounting, any gain or loss that is recognized directly in net assets/equity in accordance with paragraph 106(a) shall be reclassified into surplus or deficit as a reclassification adjustment in the same period or periods during which the foreign currency risk of the hedged transaction affects consolidated surplus or deficit.

AG137. An entity can designate all changes in the cash flows or fair value of a hedged item in a hedging relationship. An entity can also designate only changes in the cash flows or fair value of a hedged item above or below a specified price or other variable (a one-sided risk). The intrinsic value of a purchased option hedging instrument (assuming that it has the same principal terms as the designated risk), but not its time value, reflects a one-sided risk in a hedged item. For example, an entity can designate the variability of future cash flow outcomes resulting from a price increase of a forecast commodity purchase. In such a situation, only cash flow losses that result from an increase in the price above the specified level are designated. The hedged risk does not include the time value of a purchased option because the time value is not a component of the forecast transaction that affects surplus or deficit (paragraph 96(b)).

Designation of Financial Items as Hedged Items (paragraphs 90 and 91)

AG138. If a portion of the cash flows of a financial asset or financial liability is designated as the hedged item, that designated portion must be less than the total cash flows of the asset or liability. For example, in the case of a liability whose effective interest rate is below a market related interest rate, an entity cannot designate (a) a portion of the liability equal to the principal amount plus interest at a market related rate and (b) a negative residual portion. However, the entity may designate all of the cash flows of the entire financial asset or financial liability as the hedged item and hedge them for only one particular risk (e.g., only for changes that are attributable to changes in the market rate). For example, in the case of a financial liability whose effective interest rate is 100 basis points below the market rate, an entity can designate as the hedged item the entire liability (i.e., principal plus interest at the market rate minus 100 basis points) and hedge the change in the fair value or cash flows of that entire liability that is attributable to changes in the market rate. The entity may also choose a hedge ratio of other than one to one in order to improve the effectiveness of the hedge as described in paragraph AG140.

AG139. In addition, if a fixed rate financial instrument is hedged some time after its origination and interest rates have changed in the meantime, the entity can designate a portion equal to a benchmark rate that is higher than the contractual rate paid on the item. The entity can do so provided that the benchmark rate is less than the effective interest rate calculated on the assumption that the entity had purchased the instrument on the day it first designates the hedged item. For example, assume an entity originates a fixed rate financial asset of CU100 that has an effective interest rate of 6 percent at a time when the market rate is 4 percent. It begins to hedge that asset some time later when the market rate has increased to 8 percent and the fair value of the asset has decreased to CU90. The entity calculates that if it had purchased the asset on the date it first designates it as the hedged item for its then fair value of CU90, the effective yield would have been 9.5 percent. Because the market rate is less than this effective yield, the entity can designate a portion of the market rate of 8 percent that consists partly of the contractual interest cash flows and partly of the difference between the current fair value (i.e., CU90) and the amount repayable on maturity (i.e., CU100).

AG140. Paragraph 90 permits an entity to designate something other than the entire fair value change or cash flow variability of a financial instrument. For example:

(a) All of the cash flows of a financial instrument may be designated for cash flow or fair value changes attributable to some (but not all) risks; or

(b) Some (but not all) of the cash flows of a financial instrument may be designated for cash flow or fair value changes attributable to all or only some risks (i.e., a "portion" of the cash flows of the financial instrument may be designated for changes attributable to all or only some risks).

AG141. To be eligible for hedge accounting, the designated risks and portions must be separately identifiable components of the financial instrument, and changes in the cash flows or fair value of the entire financial instrument arising from changes in the designated risks and portions must be reliably measurable. For example:

(a) For a fixed rate financial instrument hedged for changes in fair value attributable to changes in a risk-free or benchmark interest rate, the risk-free or benchmark rate is normally regarded as both a separately identifiable component of the financial instrument and reliably measurable.

(b) Inflation is not separately identifiable and reliably measurable and cannot be designated as a risk or a portion of a financial instrument unless the requirements in (c) are met.

(c) A contractually specified inflation portion of the cash flows of a recognized inflation-linked bond (assuming there is no requirement to account for an embedded derivative separately) is separately identifiable and reliably measurable as long as other cash flows of the instrument are not affected by the inflation portion.

Designation of Non-Financial Items as Hedged Items (paragraph 92)

AG142. Changes in the price of an ingredient or component of a non-financial asset or non-financial liability generally do not have a predictable, separately measurable effect on the price of the item that is comparable to the effect of, say, a change in market interest rates on the price of a bond. Thus, a non-financial asset or non-financial liability is a hedged item only in its entirety or for foreign exchange risk. If there is a difference between the terms of the hedging instrument and the hedged item (such as for a hedge of the forecast purchase of Brent Crude oil using a forward contract to purchase Light Sweet Crude oil on otherwise similar terms), the hedging relationship nonetheless can qualify as a hedge relationship provided all the conditions in paragraph 98 are met, including that the hedge is expected to be highly effective. For this purpose, the amount of the hedging instrument may be greater or less than that of the hedged item if this improves the effectiveness of the hedging relationship. For example, a regression analysis could be performed to establish a statistical relationship between the hedged item (e.g., a transaction in Brent Crude oil) and the hedging instrument (e.g., a transaction in Light Sweet Crude oil). If there is a valid statistical relationship between the two variables (i.e., between the unit prices of Brent Crude oil and Light Sweet Crude oil), the slope of the regression line can be used to establish the hedge ratio that will maximize expected effectiveness. For example, if the slope of the regression line is 1.02, a hedge ratio based on 0.98 quantities of hedged items to 1.00 quantities of the hedging instrument maximizes expected effectiveness. However, the hedging relationship may result in ineffectiveness that is recognized in surplus or deficit during the term of the hedging relationship.

Designation of Groups of Items as Hedged Items (paragraphs 93 and 94)

AG143. A hedge of an overall net position (e.g., the net of all fixed rate assets and fixed rate liabilities with similar maturities), rather than of a specific hedged item, does not qualify for hedge accounting. However, almost the same effect on surplus or deficit of hedge accounting for this type of hedging relationship can be achieved by designating as the hedged item part of the underlying items. For example, if a bank has CU100 of assets and CU90 of liabilities with risks and terms of a similar nature and hedges the net CU10 exposure, it can designate as the hedged item CU10 of those assets. This designation can be used if such assets and liabilities are fixed rate instruments, in which case it is a fair value hedge, or if they are variable rate instruments, in which case it is a cash flow hedge. Similarly, if an entity has a firm commitment to make a purchase in a foreign currency of CU100 and a firm commitment to make a sale in the foreign currency of CU90, it can hedge the net amount of CU10 by acquiring a derivative and designating it as a hedging instrument associated with CU10 of the firm purchase commitment of CU100.

Hedge Accounting (paragraphs 95–113)

AG144. An example of a fair value hedge is a hedge of exposure to changes in the fair value of a fixed rate debt instrument as a result of changes in interest rates. Such a hedge could be entered into by the issuer or by the holder.

AG145. An example of a cash flow hedge is the use of a swap to change floating rate debt to fixed rate debt (i.e., a hedge of a future transaction where the future cash flows being hedged are the future interest payments).

AG146. A hedge of a firm commitment (e.g., a hedge of the change in fuel price relating to an unrecognized contractual commitment by an electric utility to purchase fuel at a fixed price) is a hedge of an exposure to a change in fair value. Accordingly, such a hedge is a fair value hedge. However, under paragraph 97 a hedge of the foreign currency risk of a firm commitment could alternatively be accounted for as a cash flow hedge.

Assessing Hedge Effectiveness

AG147. A hedge is regarded as highly effective only if both of the following conditions are met:

(a) At the inception of the hedge and in subsequent periods, the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. Such an expectation can be demonstrated in various ways, including a comparison of past changes in the fair value or cash flows of the hedged item that are attributable to the hedged risk with past changes in the fair value or cash flows of the hedging instrument, or by demonstrating a high statistical correlation between the fair value or cash flows of the hedged item and those of the hedging instrument. The entity may choose a hedge ratio of other than one to one in order to improve the effectiveness of the hedge as described in paragraph AG140.

(b) The actual results of the hedge are within a range of 80–125 percent. For example, if actual results are such that the loss on the hedging instrument is CU120 and the gain on the cash instrument is CU100, offset can be measured by 120/100, which is 120 percent, or by 100/120, which is 83 percent. In this example, assuming the hedge meets the condition in (a), the entity would conclude that the hedge has been highly effective.

AG148. Effectiveness is assessed, at a minimum, at the time an entity prepares its annual financial statements.

AG149. This Standard does not specify a single method for assessing hedge effectiveness. The method an entity adopts for assessing hedge effectiveness depends on its risk management strategy. For example, if the entity's risk management strategy is to adjust the amount of the hedging instrument periodically to reflect changes in the hedged position, the entity needs to demonstrate that the hedge is expected to be highly effective only for the period until the amount of the hedging instrument is next adjusted. In some cases, an entity adopts different methods for different types of hedges. An entity's documentation of its hedging strategy includes its procedures for assessing effectiveness. Those procedures state whether the assessment includes all of the gain or loss on a hedging instrument or whether the instrument's time value is excluded.

AG150. If an entity hedges less than 100 percent of the exposure on an item, such as 85 percent, it shall designate the hedged item as being 85 percent of the exposure and shall measure ineffectiveness based on the change in that designated 85 percent exposure. However, when hedging the designated 85 percent exposure, the entity may use a hedge ratio of other than one to one if that improves the expected effectiveness of the hedge, as explained in paragraph AG140.

AG151. If the principal terms of the hedging instrument and of the hedged asset, liability, firm commitment or highly probable forecast transaction are the same, the changes in fair value and cash flows attributable to the risk being hedged may be likely to offset each other fully, both when the hedge is entered into and afterwards. For example, an interest rate swap is likely to be an effective hedge if the notional and principal amounts, term, repricing dates, dates of interest and principal receipts and payments, and basis for measuring interest rates are the same for the hedging instrument and the hedged item. In addition, a hedge of a highly probable forecast purchase of a commodity with a forward contract is likely to be highly effective if:

(a) The forward contract is for the purchase of the same quantity of the same commodity at the same time and location as the hedged forecast purchase;

(b) The fair value of the forward contract at inception is zero; and

(c) Either the change in the discount or premium on the forward contract is excluded from the assessment of effectiveness and recognized in surplus or deficit or the change in expected cash flows on the highly probable forecast transaction is based on the forward price for the commodity.

AG152. Sometimes the hedging instrument offsets only part of the hedged risk. For example, a hedge would not be fully effective if the hedging instrument and hedged item are denominated in different currencies that do not move in tandem. Also, a hedge of interest rate risk using a derivative would not be fully effective if part of the change in the fair value of the derivative is attributable to the counterparty's credit risk.

AG153. To qualify for hedge accounting, the hedge must relate to a specific identified and designated risk, and not merely to the entity's general operational risks, and must ultimately affect the entity's surplus or deficit. A hedge of the risk of obsolescence of a physical asset or the risk of legislative changes relating to the rehabilitation of damage to the environment is not eligible for hedge accounting; effectiveness cannot be measured because those risks are not measurable reliably.

AG154. Paragraph 83(a) permits an entity to separate the intrinsic value and time value of an option contract and designate as the hedging instrument only the change in the intrinsic value of the option contract. Such a designation may result in a hedging relationship that is perfectly effective in achieving offsetting changes in cash flows attributable to a hedged one-sided risk of a forecast transaction, if the principal terms of the forecast transaction and hedging instrument are the same.

AG155. If an entity designates a purchased option in its entirety as the hedging instrument of a one-sided risk arising from a forecast transaction, the hedging relationship will not be perfectly effective. This is because the premium paid for the option includes time value and, as stated in paragraph AG135, a designated one-sided risk does not include the time value of an option. Therefore, in this situation, there will be no offset between the cash flows relating to the time value of the option premium paid and the designated hedged risk.

AG156. In the case of interest rate risk, hedge effectiveness may be assessed by preparing a maturity schedule for financial assets and financial liabilities that shows the net interest rate exposure for each time period, provided that the net exposure is associated with a specific asset or liability (or a specific group of assets or liabilities or a specific portion of them) giving rise to the net exposure, and hedge effectiveness is assessed against that asset or liability.

AG157. In assessing the effectiveness of a hedge, an entity generally considers the time value of money. The fixed interest rate on a hedged item need not exactly match the fixed interest rate on a swap designated as a fair value hedge. Nor does the variable interest rate on an interest-bearing asset or liability need to be the same as the variable interest rate on a swap designated as a cash flow hedge. A swap's fair value derives from its net settlements. The fixed and variable rates on a swap can be changed without affecting the net settlement if both are changed by the same amount.

AG158. If an entity does not meet hedge effectiveness criteria, the entity discontinues hedge accounting from the last date on which compliance with hedge effectiveness was demonstrated. However, if the entity identifies the event or change in circumstances that caused the hedging relationship to fail the effectiveness criteria, and demonstrates that the hedge was effective before the event or change in circumstances occurred, the entity discontinues hedge accounting from the date of the event or change in circumstances.

AG156A. For the avoidance of doubt, the effects of replacing the original counterparty with a clearing counterparty and making the associated changes as described in paragraphs 102(a)(ii) and 112(a)(ii) shall be reflected in the measurement of the hedging instrument and therefore in the assessment of hedge effectiveness and the measurement of hedge effectiveness.

Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk

AG159. For a fair value hedge of interest rate risk associated with a portfolio of financial assets or financial liabilities, an entity would meet the requirements of this Standard if it complies with the procedures set out in (a)–(i) and paragraphs AG158–AG175 below.

(a) As part of its risk management process the entity identifies a portfolio of items whose interest rate risk it wishes to hedge. The portfolio may comprise only assets, only liabilities or both assets and liabilities. The entity may identify two or more portfolios, in which case it applies the guidance below to each portfolio separately.

(b) The entity analyses the portfolio into repricing time periods based on expected, rather than contractual, repricing dates. The analysis into repricing time periods may be performed in various ways including scheduling cash flows into the periods in which they are expected to occur, or scheduling notional principal amounts into all periods until repricing is expected to occur.

(c) On the basis of this analysis, the entity decides the amount it wishes to hedge. The entity designates as the hedged item an amount of assets or liabilities (but not a net amount) from the identified portfolio equal to the amount it wishes to designate as being hedged. This amount also determines the percentage measure that is used for testing effectiveness in accordance with paragraph AG169(b).

(d) The entity designates the interest rate risk it is hedging. This risk could be a portion of the interest rate risk in each of the items in the hedged position, such as a benchmark interest rate (e.g., a swap rate).

(e) The entity designates one or more hedging instruments for each repricing time period.

(f) Using the designations made in (c)–(e) above, the entity assesses at inception and in subsequent periods, whether the hedge is expected to be highly effective during the period for which the hedge is designated.

(g) Periodically, the entity measures the change in the fair value of the hedged item (as designated in (c)) that is attributable to the hedged risk (as designated in (d)), on the basis of the expected repricing dates determined in (b). Provided that the hedge is determined actually to have been highly effective when assessed using the entity's documented method of assessing effectiveness, the entity recognizes the change in fair value of the hedged item as a gain or loss in surplus or deficit and in one of two line items in the statement of financial position as described in paragraph 100. The change in fair value need not be allocated to individual assets or liabilities.

(h) The entity measures the change in fair value of the hedging instrument(s) (as designated in (e)) and recognizes it as a gain or loss in surplus or deficit. The fair value of the hedging instrument(s) is recognized as an asset or liability in the statement of financial position.

(i) Any ineffectiveness will be recognized in surplus or deficit as the difference between the change in fair value referred to in (g) and that referred to in (h) (effectiveness is measured using the same materiality considerations as in other IPSASs).

AG160. This approach is described in more detail below. The approach shall be applied only to a fair value hedge of the interest rate risk associated with a portfolio of financial assets or financial liabilities.

AG161. The portfolio identified in paragraph AG157(a) could contain assets and liabilities. Alternatively, it could be a portfolio containing only assets, or only liabilities. The portfolio is used to determine the amount of the assets or liabilities the entity wishes to hedge. However, the portfolio is not itself designated as the hedged item.

AG162. In applying paragraph AG157(b), the entity determines the expected repricing date of an item as the earlier of the dates when that item is expected to mature or to reprice to market rates. The expected repricing dates are estimated at the inception of the hedge and throughout the term of the hedge, based on historical experience and other available information, including information and expectations regarding prepayment rates, interest rates and the interaction between them. Entities that have no entity-specific experience or insufficient experience use peer group experience for comparable financial instruments. These estimates are reviewed periodically and updated in the light of experience. In the case of a fixed rate item that is prepayable, the expected repricing date is the date on which the item is expected to prepay unless it reprices to market rates on an earlier date. For a group of similar items, the analysis into time periods based on expected repricing dates may take the form of allocating a percentage of the group, rather than individual items, to each time period. An entity may apply other methodologies for such allocation purposes. For example, it may use a prepayment rate multiplier for allocating amortizing loans to time periods based on expected repricing dates. However, the methodology for such an allocation shall be in accordance with the entity's risk management procedures and objectives.

AG163. As an example of the designation set out in paragraph AG157(c), if in a particular repricing time period an entity estimates that it has fixed rate assets of CU100 and fixed rate liabilities of CU80 and decides to hedge all of the net position of CU20, it designates as the hedged item assets in the amount of CU20 (a portion of the assets is designated as the Standard permits an entity to designate any amount of the available qualifying assets or liabilities, i.e., in this example any amount of the assets between CU0 and CU100). The designation is expressed as an "amount of a currency" (e.g., an amount of dollars, euro, pounds or rand) rather than as individual assets. It follows that all of the assets (or liabilities) from which the hedged amount is drawn – i.e., all of the CU100 of assets in the above example – must be:

(a) Items whose fair value changes in response to changes in the interest rate being hedged; and

(b) Items that could have qualified for fair value hedge accounting if they had been designated as hedged individually. In particular, because IPSAS 41 specifies that the fair value of a financial liability with a demand feature (such as demand deposits and some types of time deposits) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid, such an item cannot qualify for fair value hedge accounting for any time period beyond the shortest period in which the holder can demand payment. In the above example, the hedged position is an amount of assets. Hence, such liabilities are not a part of the designated hedged item, but are used by the entity to determine the amount of the asset that is designated as being hedged. If the position the entity wished to hedge was an amount of liabilities, the amount representing the designated hedged item must be drawn from fixed rate liabilities other than liabilities that the entity can be required to repay in an earlier time period, and the percentage measure used for assessing hedge effectiveness in accordance with paragraph AG169(b) would be calculated as a percentage of these other liabilities. For example, assume that an entity estimates that in a particular repricing time period it has fixed rate liabilities of CU100, comprising CU40 of demand deposits and CU60 of liabilities with no demand feature, and CU70 of fixed rate assets. If the entity decides to hedge all of the net position of CU30, it designates as the hedged item liabilities of CU30 or 50 percent (CU30 / (CU100 - CU40) = 50 percent) of the liabilities with no demand feature.

AG164. The entity also complies with the other designation and documentation requirements set out in paragraph 98(a). For a portfolio hedge of interest rate risk, this designation and documentation specifies the entity's policy for all of the variables that are used to identify the amount that is hedged and how effectiveness is measured, including the following:

(a) Which assets and liabilities are to be included in the portfolio hedge and the basis to be used for removing them from the portfolio.

(b) How the entity estimates repricing dates, including what interest rate assumptions underlie estimates of prepayment rates and the basis for changing those estimates. The same method is used for both the initial estimates made at the time an asset or liability is included in the hedged portfolio and for any later revisions to those estimates.

(c) The number and duration of repricing time periods.

(d) How often the entity will test effectiveness and which of the two methods in paragraph AG169 it will use.

(e) The methodology used by the entity to determine the amount of assets or liabilities that are designated as the hedged item and, accordingly, the percentage measure used when the entity tests effectiveness using the method described in paragraph AG169(b).

(f) When the entity tests effectiveness using the method described in paragraph AG169(b), whether the entity will test effectiveness for each repricing time period individually, for all time periods in aggregate, or by using some combination of the two.

The policies specified in designating and documenting the hedging relationship shall be in accordance with the entity's risk management procedures and objectives. Changes in policies shall not be made arbitrarily. They shall be justified on the basis of changes in market conditions and other factors and be founded on and consistent with the entity's risk management procedures and objectives.

AG165. The hedging instrument referred to in paragraph AG157(e) may be a single derivative or a portfolio of derivatives all of which contain exposure to the hedged interest rate risk designated in paragraph AG157(d). Such a portfolio of derivatives may contain offsetting risk positions. However, it may not include written options or net written options, because paragraph 86 of the Standard and paragraph AG127 do not permit such options to be designated as hedging instruments (except when a written option is designated as an offset to a purchased option). If the hedging instrument hedges the amount designated in paragraph AG157(c) for more than one repricing time period, it is allocated to all of the time periods that it hedges. However, the whole of the hedging instrument must be allocated to those repricing time periods because paragraph 84 of the Standard does not permit a hedging relationship to be designated for only a portion of the time period during which a hedging instrument remains outstanding.

AG166. When the entity measures the change in the fair value of a prepayable item in accordance with paragraph AG157(g), a change in interest rates affects the fair value of the prepayable item in two ways: it affects the fair value of the contractual cash flows and the fair value of the prepayment option that is contained in a prepayable item. Paragraph 90 of the Standard permits an entity to designate a portion of a financial asset or financial liability, sharing a common risk exposure, as the hedged item, provided effectiveness can be measured. For prepayable items, paragraph 91 permits this to be achieved by designating the hedged item in terms of the change in the fair value that is attributable to changes in the designated interest rate on the basis of expected, rather than contractual, repricing dates. However, the effect that changes in the hedged interest rate have on those expected repricing dates shall be included when determining the change in the fair value of the hedged item. Consequently, if the expected repricing dates are revised (e.g., to reflect a change in expected prepayments), or if actual repricing dates differ from those expected, ineffectiveness will arise as described in paragraph AG169. Conversely, changes in expected repricing dates that (a) clearly arise from factors other than changes in the hedged interest rate, (b) are uncorrelated with changes in the hedged interest rate, and (c) can be reliably separated from changes that are attributable to the hedged interest rate (e.g., changes in prepayment rates clearly arising from a change in demographic factors or tax regulations rather than changes in interest rate) are excluded when determining the change in the fair value of the hedged item, because they are not attributable to the hedged risk. If there is uncertainty about the factor that gave rise to the change in expected repricing dates or the entity is not able to separate reliably the changes that arise from the hedged interest rate from those that arise from other factors, the change is assumed to arise from changes in the hedged interest rate.

AG167. The Standard does not specify the techniques used to determine the amount referred to in paragraph AG157(g), namely the change in the fair value of the hedged item that is attributable to the hedged risk. If statistical or other estimation techniques are used for such measurement, management must expect the result to approximate closely that which would have been obtained from measurement of all the individual assets or liabilities that constitute the hedged item. It is not appropriate to assume that changes in the fair value of the hedged item equal changes in the value of the hedging instrument.

AG168. Paragraph 100 requires that if the hedged item for a particular repricing time period is an asset, the change in its value is presented in a separate line item within assets. Conversely, if the hedged item for a particular repricing time period is a liability, the change in its value is presented in a separate line item within liabilities. These are the separate line items referred to in paragraph AG157(g). Specific allocation to individual assets (or liabilities) is not required.

AG169. Paragraph AG157(i) notes that ineffectiveness arises to the extent that the change in the fair value of the hedged item that is attributable to the hedged risk differs from the change in the fair value of the hedging derivative. Such a difference may arise for a number of reasons, including:

(a) Actual repricing dates being different from those expected, or expected repricing dates being revised;

(b) Items in the hedged portfolio becoming impaired or being derecognized;

(c) The payment dates of the hedging instrument and the hedged item being different; and

(d) Other causes (e.g., when a few of the hedged items bear interest at a rate below the benchmark rate for which they are designated as being hedged, and the resulting ineffectiveness is not so great that the portfolio as a whole fails to qualify for hedge accounting).

Such ineffectiveness (applying the same materiality considerations in other IPSASs) shall be identified and recognized in surplus or deficit.

AG170. Generally, the effectiveness of the hedge will be improved:

(a) If the entity schedules items with different prepayment characteristics in a way that takes account of the differences in prepayment behavior.

(b) When the number of items in the portfolio is larger. When only a few items are contained in the portfolio, relatively high ineffectiveness is likely if one of the items prepays earlier or later than expected. Conversely, when the portfolio contains many items, the prepayment behavior can be predicted more accurately.

(c) When the repricing time periods used are narrower (e.g., 1-month as opposed to 3-month repricing time periods). Narrower repricing time periods reduce the effect of any mismatch between the repricing and payment dates (within the repricing time period) of the hedged item and those of the hedging instrument.

(d) The greater the frequency with which the amount of the hedging instrument is adjusted to reflect changes in the hedged item (e.g., because of changes in prepayment expectations).

AG171. An entity tests effectiveness periodically. If estimates of repricing dates change between one date on which an entity assesses effectiveness and the next, it shall calculate the amount of effectiveness either:

(a) As the difference between the change in the fair value of the hedging instrument (see paragraph AG157(h)) and the change in the value of the entire hedged item that is attributable to changes in the hedged interest rate (including the effect that changes in the hedged interest rate have on the fair value of any embedded prepayment option); or

(b) Using the following approximation. The entity:

(i) Calculates the percentage of the assets (or liabilities) in each repricing time period that was hedged, on the basis of the estimated repricing dates at the last date it tested effectiveness.

(ii) Applies this percentage to its revised estimate of the amount in that repricing time period to calculate the amount of the hedged item based on its revised estimate.

(iii) Calculates the change in the fair value of its revised estimate of the hedged item that is attributable to the hedged risk and presents it as set out in paragraph AG157(g).

(iv) Recognizes ineffectiveness equal to the difference between the amount determined in (iii) and the change in the fair value of the hedging instrument (see paragraph AG157(h)).

AG172. When measuring effectiveness, the entity distinguishes revisions to the estimated repricing dates of existing assets (or liabilities) from the origination of new assets (or liabilities), with only the former giving rise to ineffectiveness. All revisions to estimated repricing dates (other than those excluded in accordance with paragraph AG164), including any reallocation of existing items between time periods, are included when revising the estimated amount in a time period in accordance with paragraph AG169(b)(ii) and hence when measuring effectiveness. Once ineffectiveness has been recognized as set out above, the entity establishes a new estimate of the total assets (or liabilities) in each repricing time period, including new assets (or liabilities) that have been originated since it last tested effectiveness, and designates a new amount as the hedged item and a new percentage as the hedged percentage. The procedures set out in paragraph AG169(b) are then repeated at the next date it tests effectiveness.

AG173. Items that were originally scheduled into a repricing time period may be derecognized because of earlier than expected prepayment or write-offs caused by impairment or sale. When this occurs, the amount of change in fair value included in the separate line item referred to in paragraph AG157(g) that relates to the derecognized item shall be removed from the statement of financial position, and included in the gain or loss that arises on derecognition of the item. For this purpose, it is necessary to know the repricing time period(s) into which the derecognized item was scheduled, because this determines the repricing time period(s) from which to remove it and hence the amount to remove from the separate line item referred to in paragraph AG157(g). When an item is derecognized, if it can be determined in which time period it was included, it is removed from that time period. If not, it is removed from the earliest time period if the derecognition resulted from higher than expected prepayments, or allocated to all time periods containing the derecognized item on a systematic and rational basis if the item was sold or became impaired.

AG174. In addition, any amount relating to a particular time period that has not been derecognized when the time period expires is recognized in surplus or deficit at that time (see paragraph 100). For example, assume an entity schedules items into three repricing time periods. At the previous redesignation, the change in fair value reported in the single line item in the statement of financial position was an asset of CU25. That amount represents amounts attributable to periods 1, 2 and 3 of CU7, CU8 and CU10, respectively. At the next redesignation, the assets attributable to period 1 have been either realized or rescheduled into other periods. Therefore, CU7 is derecognized from the statement of financial position and recognized in surplus or deficit. CU8 and CU10 are now attributable to periods 1 and 2, respectively. These remaining periods are then adjusted, as necessary, for changes in fair value as described in paragraph AG157(g).

AG175. As an illustration of the requirements of the previous two paragraphs, assume that an entity scheduled assets by allocating a percentage of the portfolio into each repricing time period. Assume also that it scheduled CU100 into each of the first two time periods. When the first repricing time period expires, CU110 of assets are derecognized because of expected and unexpected repayments. In this case, all of the amount contained in the separate line item referred to in paragraph AG157(g) that relates to the first time period is removed from the statement of financial position, plus 10 percent of the amount that relates to the second time period.

AG176. If the hedged amount for a repricing time period is reduced without the related assets (or liabilities) being derecognized, the amount included in the separate line item referred to in paragraph AG157(g) that relates to the reduction shall be amortized in accordance with paragraph 104.

AG177. An entity may wish to apply the approach set out in paragraphs AG157–AG174 to a portfolio hedge that had previously been accounted for as a cash flow hedge in accordance with IPSAS 29. Such an entity would revoke the previous designation of a cash flow hedge in accordance with paragraph 112(d), and apply the requirements set out in that paragraph. It would also redesignate the hedge as a fair value hedge and apply the approach set out in paragraphs AG157–AG174 prospectively to subsequent accounting periods.

Appendix B

Reassessment of Embedded Derivatives

B1–B7. [Deleted]

Appendix C

Hedges of a Net Investment in a Foreign Operation

This Appendix is an integral part of IPSAS 29.

Introduction

C1. Many reporting entities have investments in foreign operations (as defined in IPSAS 4, paragraph 10). Such foreign operations may be controlled entities, associates, joint ventures or branches. IPSAS 4 requires an entity to determine the functional currency of each of its foreign operations as the currency of the primary economic environment of that operation. When translating the results and financial position of a foreign operation into a presentation currency, the entity is required to recognize foreign exchange differences directly in net assets/equity until it disposes of the foreign operation.

C2. Hedge accounting of the foreign currency risk arising from a net investment in a foreign operation will apply only when the net assets of that foreign operation are included in the financial statements. This will be the case for consolidated financial statements, financial statements in which investments such as associates or joint venters are accounted for using the equity method and financial statements that include a branch or joint operations as defined in IPSAS 37. The item being hedged with respect to the foreign currency risk arising from the net investment in a foreign operation may be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation.

C3. IPSAS 29 requires the designation of an eligible hedged item and eligible hedging instruments in a hedge accounting relationship. If there is a designated hedging relationship, in the case of a net investment hedge, the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment is recognized directly in net assets/equity and is included with the foreign exchange differences arising on translation of the results and financial position of the foreign operation.

C4. This appendix applies to an entity that hedges the foreign currency risk arising from its net investments in foreign operations and wishes to qualify for hedge accounting in accordance with IPSAS 29. It should not be applied by analogy to other types of hedge accounting. This appendix refers to such an entity as a controlling entity and to the financial statements in which the net assets of foreign operations are included as consolidated financial statements. All references to a controlling entity apply equally to an entity that has a net investment in a foreign operation that is a joint venture, an associate or a branch.

C5. This appendix provides guidance on:

(a) Identifying the foreign currency risks that qualify as a hedged risk in the hedge of a net investment in a foreign operation, given that an entity with many foreign operations may be exposed to a number of foreign currency risks. It specifically addresses:

(i) Whether the controlling entity may designate as a hedged risk only the foreign exchange differences arising from a difference between the functional currencies of the controlling entity and its foreign operation, or whether it may also designate as the hedged risk the foreign exchange differences arising from the difference between the presentation currency of the controlling entity's consolidated financial statements and the functional currency of the foreign operation; and

(ii) If the controlling entity holds the foreign operation indirectly, whether the hedged risk may include only the foreign exchange differences arising from differences in functional currencies between the foreign operation and its immediate controlling entity, or whether the hedged risk may also include any foreign exchange differences between the functional currency of the foreign operation and any intermediate or ultimate controlling entity (i.e., whether the fact that the net investment in the foreign operation is held through an intermediate controlling entity affects the economic risk to the ultimate controlling entity).

(b) Where in an economic entity the hedging instrument can be held. It specifically addresses:

(i) IPSAS 29 allows an entity to designate either a derivative or a non-derivative financial instrument (or a combination of derivative and non-derivative financial instruments) as hedging instruments for foreign currency risk. This appendix addresses whether the nature of the hedging instrument (derivative or non-derivative) or the method of consolidation affects the assessment of hedge effectiveness.

(ii) This appendix also addresses where, within an economic entity, hedging instruments that are hedges of a net investment in a foreign operation can be held to qualify for hedge accounting i.e., whether a qualifying hedge accounting relationship can be established only if the entity hedging its net investment is a party to the hedging instrument or whether any entity within the economic entity, regardless of its functional currency, can hold the hedging instrument.

(c) How an entity should determine what amount of the gain or loss recognized in net assets/equity should be recognized directly in surplus or deficit for both the hedging instrument and the hedged item as IPSAS 4 and IPSAS 29 require cumulative amounts recognized directly in net assets/equity relating to both the foreign exchange differences arising on translation of the results and financial position of the foreign operation and the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment to be recognized directly when the controlling entity disposes of the foreign operation. It specifically addresses:

(i) When a foreign operation that was hedged is disposed of, what amounts from the controlling entity's foreign currency translation reserve in respect of the hedging instrument and of that foreign operation should be recognized in surplus or deficit in the controlling entity's consolidated financial statements; and

(ii) Whether the method of consolidation affects the determination of the amounts to be recognized in surplus or deficit.

Application of IPSAS 29 to Hedges of a Net Investment in a Foreign Operation

Nature of the Hedged Risk and Amount of the Hedged Item for which a Hedging Relationship may be Designated

C6. Hedge accounting may be applied only to the foreign exchange differences arising between the functional currency of the foreign operation and the controlling entity's functional currency.

C7. In a hedge of the foreign currency risks arising from a net investment in a foreign operation, the hedged item can be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation in the consolidated financial statements of the controlling entity. The carrying amount of the net assets of a foreign operation that may be designated as the hedged item in the consolidated financial statements of a controlling entity depends on whether any lower level controlling entity of the foreign operation has applied hedge accounting for all or part of the net assets of that foreign operation and that accounting has been maintained in the controlling entity's consolidated financial statements.

C8. The hedged risk may be designated as the foreign currency exposure arising between the functional currency of the foreign operation and the functional currency of any controlling entity (the immediate, intermediate or ultimate controlling entity) of that foreign operation. The fact that the net investment is held through an intermediate controlling entity does not affect the nature of the economic risk arising from the foreign currency exposure to the ultimate controlling entity.

C9. An exposure to foreign currency risk arising from a net investment in a foreign operation may qualify for hedge accounting only once in the consolidated financial statements. Therefore, if the same net assets of a foreign operation are hedged by more than one controlling entity within the economic entity (e.g., both a direct and an indirect controlling entity) for the same risk, only one hedging relationship will qualify for hedge accounting in the consolidated financial statements of the ultimate controlling entity. A hedging relationship designated by one controlling entity in its consolidated financial statements need not be maintained by another higher level controlling entity. However, if it is not maintained by the higher level controlling entity, the hedge accounting applied by the lower level controlling entity must be reversed before the higher level controlling entity's hedge accounting is recognized.

Where the Hedging Instrument can be Held

C10. A derivative or a non-derivative instrument (or a combination of derivative and non-derivative instruments) may be designated as a hedging instrument in a hedge of a net investment in a foreign operation. The hedging instrument(s) may be held by any entity or entities within the economic entity (except the foreign operation that itself is being hedged), as long as the designation, documentation and effectiveness requirements of IPSAS 29 paragraph 98 that relate to a net investment hedge are satisfied. In particular, the hedging strategy of the economic entity should be clearly documented because of the possibility of different designations at different levels of the economic entity.

C11. For the purpose of assessing effectiveness, the change in value of the hedging instrument in respect of foreign exchange risk is computed by reference to the functional currency of the controlling entity against whose functional currency the hedged risk is measured, in accordance with the hedge accounting documentation. Depending on where the hedging instrument is held, in the absence of hedge accounting the total change in value might be recognized in surplus or deficit, directly in net assets/equity, or both. However, the assessment of effectiveness is not affected by whether the change in value of the hedging instrument is recognized in surplus or deficit or directly in net assets/equity. As part of the application of hedge accounting, the total effective portion of the change is included directly in net assets/equity. The assessment of effectiveness is not affected by whether the hedging instrument is a derivative or a non-derivative instrument or by the method of consolidation.

Disposal of a Hedged Foreign Operation

C12. When a foreign operation that was hedged is disposed of, the amount reclassified to surplus or deficit from the foreign currency translation reserve in the consolidated financial statements of the controlling entity in respect of the hedging instrument is the amount that IPSAS 29 paragraph 113 requires to be identified. That amount is the cumulative gain or loss on the hedging instrument that was determined to be an effective hedge.

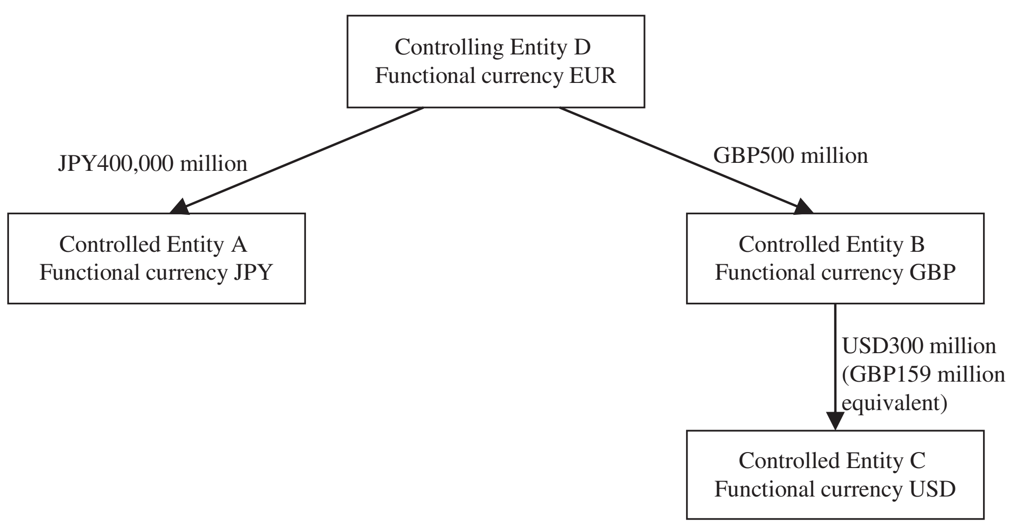
C13. The amount recognized in surplus or deficit upon transfer from the foreign currency translation reserve in the consolidated financial statements of a controlling entity in respect of the net investment in that foreign operation in accordance with IPSAS 4 paragraph 57 is the amount included in that controlling entity's foreign currency translation reserve in respect of that foreign operation. In the ultimate controlling entity's consolidated financial statements, the aggregate net amount recognized in the foreign currency translation reserve in respect of all foreign operations is not affected by the consolidation method. However, whether the ultimate controlling entity uses the direct or the step-by-step method of consolidation, this may affect the amount included in its foreign currency translation reserve in respect of an individual foreign operation.

C14. The direct method is the method of consolidation in which the financial statements of the foreign operation are translated directly into the functional currency of the ultimate controlling entity. The step-by-step method is the method of consolidation in which the financial statements of the foreign operation are first translated into the functional currency of any intermediate controlling entity(ies) and then translated into the functional currency of the ultimate controlling entity (or the presentation currency if different).

C15. The use of the step-by-step method of consolidation may result in a different amount being recognized in surplus or deficit from that used to determine hedge effectiveness. This difference may be eliminated by determining the amount relating to that foreign operation that would have arisen if the direct method of consolidation had been used. Making this adjustment is not required by IPSAS 4. However, it is an accounting policy choice that should be followed consistently for all net investments.

Example

C16. The following example illustrates the application of the preceding paragraphs using the entity structure illustrated below. In all cases the hedging relationships described would be tested for effectiveness in accordance with IPSAS 29, although this testing is not discussed. Controlling Entity D, being the ultimate controlling entity, presents its consolidated financial statements in its functional currency of euro (EUR). Each of the controlled entities i.e., Controlled Entity A, Controlled Entity B and Controlled Entity C, is wholly owned. Controlling Entity D £500 million net investment in Controlled Entity B (functional currency pounds sterling (GBP)) includes the £159 million equivalent of Controlled Entity B's US$300 million net investment in Controlled Entity C (functional currency US dollars (USD)). In other words, Controlled Entity B's net assets other than its investment in Controlled Entity C are £341 million.



Nature of Hedged Risk for which a Hedging Relationship may be Designated (paragraphs C6–C9)

C17. Controlling Entity D can hedge its net investment in each of Controlled Entities A, B and C for the foreign exchange risk between their respective functional currencies (Japanese yen (JPY), pounds sterling and US dollars) and euro. In addition, Controlled Entity D can hedge the USD/GBP foreign exchange risk between the functional currencies of Controlled Entity B and Controlled Entity C. In its consolidated financial statements, Controlled Entity B can hedge its net investment in Controlled Entity C for the foreign exchange risk between their functional currencies of US dollars and pounds sterling. In the following examples the designated risk is the spot foreign exchange risk because the hedging instruments are not derivatives. If the hedging instruments were forward contracts, Controlling Entity D could designate the forward foreign exchange risk.

Amount of Hedged item for which a Hedging Relationship may be Designated (paragraphs C6–C9)

C18. Controlling Entity D wishes to hedge the foreign exchange risk from its net investment in Controlled Entity C. Assume that Controlled Entity A has an external borrowing of US$300 million. The net assets of Controlled Entity A at the start of the reporting period are ¥400,000 million including the proceeds of the external borrowing of US$300 million.

C19. The hedged item can be an amount of net assets equal to or less than the carrying amount of Controlling Entity D's net investment in Controlled Entity C (US$300 million) in its consolidated financial statements. In its consolidated financial statements Controlling Entity D can designate the US$300 million external borrowing in Controlled Entity A as a hedge of the EUR/USD spot foreign exchange risk associated with its net investment in the US$300 million net assets of Controlled Entity C. In this case, both the EUR/USD foreign exchange difference on the US$300 million external borrowing in Controlled Entity A and the EUR/USD foreign exchange difference on the US$300 million net investment in Controlled Entity C are included in the foreign currency translation reserve in Controlling Entity D's consolidated financial statements after the application of hedge accounting.

C20. In the absence of hedge accounting, the total USD/EUR foreign exchange difference on the US$300 million external borrowing in Controlled Entity A would be recognized in Controlling Entity D's consolidated financial statements as follows:

- USD/JPY spot foreign exchange rate change, translated to euro, in surplus or deficit; and
- JPY/EUR spot foreign exchange rate change directly in net assets/equity.

Instead of the designation in paragraph C19, in its consolidated financial statements Controlling Entity D can designate the US$300 million external borrowing in Controlled Entity A as a hedge of the GBP/USD spot foreign exchange risk between Controlled Entity C and Controlled Entity B. In this case, the total USD/EUR foreign exchange difference on the US$300 million external borrowing in Entity A would instead be recognized in Controlled Entity D's consolidated financial statements as follows:

- The GBP/USD spot foreign exchange rate change in the foreign currency translation reserve relating to Controlled Entity C;
- GBP/JPY spot foreign exchange rate change, translated to euro, in surplus or deficit; and
- JPY/EUR spot foreign exchange rate change directly in net assets/equity.

C21. Controlling Entity D cannot designate the US$300 million external borrowing in Controlled Entity A as a hedge of both the EUR/USD spot foreign exchange risk and the GBP/USD spot foreign exchange risk in its consolidated financial statements. A single hedging instrument can hedge the same designated risk only once. Controlled Entity B cannot apply hedge accounting in its consolidated financial statements because the hedging instrument is held outside the economic entity comprising Controlled Entity B and Controlled Entity C.

Where in an Economic Entity can the Hedging Instrument be Held (paragraphs C10 and C11)?

C22. As noted in paragraph C20, the total change in value in respect of foreign exchange risk of the US$300 million external borrowing in Controlled Entity A would be recorded in both surplus or deficit (USD/JPY spot risk) and directly in net assets/equity (EUR/JPY spot risk) in Controlling Entity D's consolidated financial statements in the absence of hedge accounting. Both amounts are included for the purpose of assessing the effectiveness of the hedge designated in paragraph C19 because the change in value of both the hedging instrument and the hedged item are computed by reference to the euro functional currency of Controlling Entity D against the US dollar functional currency of Controlled Entity C, in accordance with the hedge documentation. The method of consolidation (i.e., direct method or step-by-step method) does not affect the assessment of the effectiveness of the hedge.

Amounts Recognized in Surplus or Deficit on Disposal of a Foreign Operation (paragraphs C12 and C13)

C24. When Controlled Entity C is disposed of, the amounts are recognized in surplus or deficit in Controlling Entity D's consolidated financial statements upon transfer from its foreign currency translation reserve (FCTR) are:

(a) In respect of the US$300 million external borrowing of Controlled Entity A, the amount that IPSAS 29 requires to be identified, i.e., the total change in value in respect of foreign exchange risk that was recognized directly in net assets/equity as the effective portion of the hedge; and

(b) In respect of the US$300 million net investment in Controlled Entity C, the amount determined by the entity's consolidation method. If Controlling Entity D uses the direct method, its FCTR in respect of Controlled Entity C will be determined directly by the EUR/USD foreign exchange rate. If Controlling Entity D uses the step-by-step method, its FCTR in respect of Controlled Entity C will be determined by the FCTR recognized by Controlled Entity B reflecting the GBP/USD foreign exchange rate, translated to Controlling Entity D's functional currency using the EUR/GBP foreign exchange rate. Controlling Entity D's use of the step-by-step method of consolidation in prior periods does not require it to or preclude it from determining the amount of FCTR to be recognized in surplus or deficit when it disposes of Controlled Entity C to be the amount that it would have recognized if it had always used the direct method, depending on its accounting policy.

Hedging More Than One Foreign Operation (paragraphs C7, C9, and C11)

C25. The following examples illustrate that in the consolidated financial statements of Controlling Entity D, the risk that can be hedged is always the risk between its functional currency (euro) and the functional currencies of Controlled Entities B and C. No matter how the hedges are designated, the maximum amounts that can be effective hedges to be included in the foreign currency translation reserve in Controlling Entity D's consolidated financial statements when both foreign operations are hedged are US$300 million for EUR/USD risk and £341 million for EUR/GBP risk. Other changes in value due to changes in foreign exchange rates are included in Controlling Entity D's consolidated surplus or deficit. Of course, it would be possible for Controlling Entity D to designate US$300 million only for changes in the USD/GBP spot foreign exchange rate or £500 million only for changes in the GBP/EUR spot foreign exchange rate.

Entity D Holds Both USD and GBP Hedging Instruments

C26. Controlling Entity D may wish to hedge the foreign exchange risk in relation to its net investment in Controlled Entity B as well as that in relation to Controlled Entity C. Assume that Controlling Entity D holds suitable hedging instruments denominated in US dollars and pounds sterling that it could designate as hedges of its net investments in Controlled Entity B and Controlled Entity C. The designations Controlling Entity D can make in its consolidated financial statements include, but are not limited to, the following:

(a) US$300 million hedging instrument designated as a hedge of the US$300 million of net investment in Controlled Entity C with the risk being the spot foreign exchange exposure (EUR/USD) between Controlling Entity D and Controlled Entity C and up to £341 million hedging instrument designated as a hedge of £341 million of the net investment in Controlled Entity B with the risk being the spot foreign exchange exposure (EUR/GBP) between Controlling Entity D and Controlled Entity B.

(b) US$300 million hedging instrument designated as a hedge of the US$300 million of net investment in Controlled Entity C with the risk being the spot foreign exchange exposure (GBP/USD) between Controlled Entity B and Controlled Entity C and up to £500 million hedging instrument designated as a hedge of £500 million of the net investment in Controlled Entity B with the risk being the spot foreign exchange exposure (EUR/GBP) between Controlling Entity D and Controlled Entity B.

C27. The EUR/USD risk from Controlling Entity D's net investment in Controlled Entity C is a different risk from the EUR/GBP risk from Controlling Entity D's net investment in Controlled Entity B. However, in the case described in paragraph C25(a), by its designation of the USD hedging instrument it holds, Controlling Entity D has already fully hedged the EUR/USD risk from its net investment in Controlled Entity C. If Controlling Entity D also designated a GBP instrument it holds as a hedge of its £500 million net investment in Controlled Entity B, £159 million of that net investment, representing the GBP equivalent of its USD net investment in Controlled Entity C, would be hedged twice for GBP/EUR risk in Controlling Entity D's consolidated financial statements.

C28. In the case described in paragraph C25(b), if Controlling Entity D designates the hedged risk as the spot foreign exchange exposure (GBP/USD) between Controlled Entity B and Controlled Entity C, only the GBP/USD part of the change in the value of its US$300 million hedging instrument is included in Controlling Entity D's foreign currency translation reserve relating to Controlled Entity C. The remainder of the change (equivalent to the GBP/EUR change on £159 million) is included in Controlling Entity D's consolidated surplus or deficit, as in paragraph C20. Because the designation of the USD/GBP risk between Controlled entities B and C does not include the GBP/EUR risk, Controlled Entity D is also able to designate up to £500 million of its net investment in Controlled Entity B with the risk being the spot foreign exchange exposure (GBP/EUR) between Controlling Entity D and Controlled Entity B.

Entity B Holds the USD Hedging Instrument

C29. Assume that Controlled Entity B holds US$300 million of external debt, the proceeds of which were transferred to Controlling Entity D by an inter-entity loan denominated in pounds sterling. Because both its assets and liabilities increased by £159 million, Controlled Entity B's net assets are unchanged. Controlled Entity B could designate the external debt as a hedge of the GBP/USD risk of its net investment in Controlled Entity C in its consolidated financial statements. Controlling Entity D could maintain Controlled Entity B's designation of that hedging instrument as a hedge of its US$300 million net investment in Controlled Entity C for the GBP/USD risk (see paragraph C9) and Controlling Entity D could designate the GBP hedging instrument it holds as a hedge of its entire £500 million net investment in Controlled Entity B. The first hedge, designated by Controlled Entity B, would be assessed by reference to Controlled Entity B's functional currency (pounds sterling) and the second hedge, designated by Controlling Entity D, would be assessed by reference to Controlling Entity D's functional currency (euro). In this case, only the GBP/USD risk from Controlling Entity D's net investment in Controlled Entity C has been hedged in Controlling Entity D's consolidated financial statements by the USD hedging instrument, not the entire EUR/USD risk. Therefore, the entire EUR/GBP risk from Controlling Entity D's £500 million net investment in Controlled Entity B may be hedged in the consolidated financial statements of Controlling Entity D.

C30. However, the accounting for Controlled Entity D's £159 million loan payable to Controlled Entity B must also be considered. If Controlling Entity D's loan payable is not considered part of its net investment in Controlled Entity B because it does not satisfy the conditions in IPSAS 4 paragraph 18, the GBP/EUR foreign exchange difference arising on translating it would be included in Controlling Entity D's consolidated surplus or deficit. If the £159 million loan payable to Controlled Entity B is considered part of Controlling Entity D's net investment, that net investment would be only £341 million and the amount Controlling Entity D could designate as the hedged item for GBP/EUR risk would be reduced from £500 million to £341 million accordingly.

C31. If Controlling Entity D reversed the hedging relationship designated by Controlled Entity B, Controlling Entity D could designate the US$300 million external borrowing held by Controlled Entity B as a hedge of its US$300 million net investment in Controlled Entity C for the EUR/USD risk and designate the GBP hedging instrument it holds itself as a hedge of only up to £341 million of the net investment in Controlled Entity B. In this case the effectiveness of both hedges would be computed by reference to Controlling Entity D's functional currency (euro). Consequently, both the USD/GBP change in value of the external borrowing held by Controlled Entity B and the GBP/EUR change in value of Controlling Entity D's loan payable to Controlled Entity B (equivalent to USD/EUR in total) would be included in the foreign currency translation reserve in Controlling Entity D's consolidated financial statements. Because Controlling Entity D has already fully hedged the EUR/USD risk from its net investment in Controlled Entity C, it can hedge only up to £341 million for the EUR/GBP risk of its net investment in Controlled Entity B.

Appendix D

Amendments to Other IPSASs

[Deleted]

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 29.

Introduction

BC1. This Basis for Conclusions summarizes the IPSASB's considerations in reaching the conclusions in IPSAS 29, *Financial Instruments: Recognition and Measurement*. As this Standard is based on IAS 39, *Financial Instruments: Recognition and Measurement* issued by the IASB, the Basis for Conclusions outlines only those areas where IPSAS 29 departs from the main requirements of IAS 39.

BC2. This project on financial instruments forms part of the IPSASB's convergence program which aims to converge IPSASs with IFRSs. The IPSASB acknowledges that there are other aspects of financial instruments, insofar as they relate to the public sector, which are not addressed in IAS 39. These will be addressed by future projects of the IPSASB. In particular, the IPSASB acknowledges that future projects are required to address:

- Certain transactions undertaken by central banks; and
- Receivables and payables that arise from arrangements that are, in substance, similar to, and have the same economic effect as, financial instruments, but are not contractual in nature.

BC3. In developing this Standard, the IPSASB agreed to retain the existing text of IAS 39 wherever consistent with existing IPSASs, and deal with certain public sector specific issues through additional application guidance.

BC4. In September 2007, the IASB issued amendments to IAS 1, *Presentation of Financial Statements* which introduced "comprehensive income" into the presentation of financial statements. As the IPSASB has not yet considered comprehensive income, along with some of the other amendments proposed in IAS 1, those amendments have not been included in IPSAS 29. The text of IAS 39 as published at December 31, 2008, including certain amendments made by the IASB to IAS 39 in April 2009 as part of its improvements project, have been included in the text of IPSAS 29. The IPSASB acknowledged that IFRS 9, *Financial Instruments* was issued in November 2009. The IPSASB also recognized that the IASB plans further significant modifications to IAS 39. The IPSASB therefore decided to consider any modifications to IASB requirements for financial instruments as part of a future project.[1]

Scope

BC5. Assets and liabilities may arise out of contractual non-exchange revenue transactions. The initial recognition and measurement of assets and liabilities arising out of non-exchange revenue transactions is addressed in IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. IPSAS 23 does not provide requirements and guidance for the subsequent measurement or derecognition of these assets and liabilities. The IPSASB considered the interaction between this Standard and IPSAS 23 for assets and liabilities that arise out of non-exchange revenue transactions that meet the definition of financial assets and financial liabilities.

BC6. The IPSASB agreed that where an asset acquired in a non-exchange transaction is a financial asset, an entity:

- Initially recognizes the asset using IPSAS 23; and
- Initially measures the asset using IPSAS 23 and, considers the requirements in this Standard to determine the appropriate treatment for any transaction costs incurred to acquire the asset.

As IPSAS 23 does not prescribe subsequent measurement or derecognition requirements for assets acquired in a non-exchange transaction, this Standard is applied to those assets if they are financial assets.

BC7. For liabilities, the IPSASB agreed that liabilities arising from conditions imposed on a transfer of resources in accordance with IPSAS 23 are initially recognized and initially measured using that IPSAS, as these liabilities usually do not meet the definition of a financial liability at initial recognition (see IPSAS 28). After initial recognition, if circumstances indicate that the liability is a financial liability, an entity assesses if the liability recognized in accordance with IPSAS 23 should be derecognized and a financial liability recognized in accordance with this Standard.

BC8. The IPSASB agreed that other liabilities that arise from non-exchange revenue transactions, for example, the return of resources based on a restriction on the use of an asset, are recognized and measured in accordance with this Standard if they meet the definition of a financial liability.

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[1] In January 2015 the IPSASB introduced the concept of investment entities in IPSAS 35 and required investment entities, as defined in that Standard, to measure their investments in controlled entities, other than those providing investment-related services or activities, at fair value through surplus or deficit.

Initial Measurement

BC9. The IPSASB acknowledged that there is an interaction between IPSAS 23 and this Standard for assets acquired through a non-exchange transaction that also meet the definition of a financial asset. IPSAS 23 requires that assets acquired in a non-exchange revenue transaction are measured initially at fair value. This Standard requires financial assets to be measured initially at fair value, plus transaction costs, if the asset is not subsequently measured at fair value through surplus or deficit. The two measurement approaches are broadly consistent, except for the treatment of transaction costs.

BC10. The IPSASB concluded that it would be inappropriate for financial assets arising from non-exchange transactions to be measured differently from those arising from exchange transactions. Consequently, the IPSASB agreed that assets acquired in a non-exchange transaction should be measured initially at fair value using the requirements in IPSAS 23, but that this Standard should also be considered where transaction costs are incurred to acquire the asset.

Concessionary Loans

BC11. Concessionary loans can either be granted or received by an entity. They pose particular accounting issues because their terms are not market related. The IPSASB therefore considered how the off-market portion of a concessionary loan should be accounted for. In ED 38, the IPSASB proposed that an entity should account for concessionary loans by analyzing the substance of the transaction into its component parts and accounting for each component separately and that the IPSASB therefore determined that the off-market portion of a concessionary loan should be accounted for as follows:

- The issuer of a concessionary loan accounts for the off-market portion of the loan as an expense in the year the loan is issued; and
- The recipient of a concessionary loan accounts for the off-market portion of the loan in accordance with IPSAS 23.

BC12. Some respondents to ED 38 disagreed with the proposed treatment of concessionary loans because they do not believe that fair value is an appropriate measurement basis, while others disagreed with the proposed treatment of the off-market portion of concessionary loans as an expense.

BC13. Respondents who disagreed with fair value as a measurement basis cited both conceptual and practical difficulties in measuring concessionary loans at fair value. At a conceptual level, it was noted that some concessionary loans issued by public sector entities may not be available in an orderly market because of the risk profiles of the borrowers, e.g., small business loans, or loans granted by governments in their capacity as a lender of last resort. For loans that would not ordinarily be found in an orderly market, respondents argued that while it may be possible to obtain a fair value, that fair value does not provide a faithful representation of the transaction. They argued that because an orderly market for such transactions does not exist, the transaction price on initial measurement represents the fair value of the loan. Those respondents who cited practical difficulties in determining fair value noted that, because of these difficulties, fair values are often determined using estimates. In their view the use of such estimates would make the information potentially unreliable. As a means of overcoming these practical difficulties, respondents suggested that, as an alternative to fair value, nominal cost or the lender's borrowing rate should be used as a measurement basis.

BC14. The IPSASB takes the view that the use of fair value enables the most faithfully representative determination of the concession element of a concessionary loan. Also, because the loans granted at no or low interest are not unique to the public sector, the IPSASB was not persuaded that there is a public sector specific reason to depart from the fair value principles in IAS 39. They also noted that IPSAS 30 requires specific disclosures on the measurement of financial instruments, including those instances where unobservable market inputs have been used. Consequently, the IPSASB decided to retain fair value as a measurement basis for concessionary loans.

BC15. Respondents who disagreed with expensing the off-market portion of the concessionary loan, noted that because the off-market portion represents a subsidy, it may be more appropriate to recognize an asset initially and recognize an expense subsequently by reducing this asset as and when the conditions of the subsidy are met or on a time proportion basis. The IPSASB, however, considered that the initial granting of the loan results in a commitment of resources, in the form of a loan and a subsidy, on day one. The IPSASB was of the view that initial recognition of this subsidy as an expense on recognition of the transaction provides the most useful information for accountability purposes.

Financial Guarantees Issued Through a Non-Exchange Transaction

BC16. The IPSASB acknowledged that in the public sector financial guarantee contracts are frequently issued through a non-exchange transaction, i.e., they are issued for no consideration or for nominal consideration, often in order to further the issuer's broad social policy objectives, rather than for commercial purposes. While entities may issue guarantees at below fair value in the private sector, this is not common and is for commercial reasons, such as when a controlling entity issues a guarantee to a holder on behalf of a controlled entity. In the public sector the maximum credit risk exposure of such guarantees may be extremely large. Such guarantees are generally issued because an active market does not exist and, in some cases, it would be impossible for the guarantee to be provided by a private sector issuer because of the maximum extent of the credit risk exposure. The IPSASB considered the approach to measurement at initial recognition, and subsequent to initial recognition, for such financial guarantee contracts.

BC17. Where the financial guarantee contract is entered into for consideration, the IPSASB considered whether the amount of such consideration should be deemed to be a fair value. Application Guidance in IAS 39 states that "the fair value of a financial instrument on initial recognition is normally the transaction price." In the public sector the IPSASB considered that in many cases the transaction price related to a financial guarantee contract will not reflect fair value and that recognition at such an amount would be an inaccurate and misleading reflection of the issuer's exposure to financial risk. The IPSASB concluded that where there is consideration for a financial guarantee, an entity should determine whether that consideration arises from an exchange transaction and therefore represents a fair value. If the consideration does represent a fair value, the IPSASB concluded that entities should recognize the financial guarantee at the amount of the consideration and that subsequent measurement should be at the higher of the amount determined in accordance with IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognized, less, when appropriate, cumulative amortization recognized in accordance with IPSAS 9, *Revenue from Exchange Transactions*. Where the transaction price is not a fair value, an entity should be required to determine measurement at initial recognition in the same way as if no consideration had been paid.

BC18. The IPSASB therefore considered the approach to the determination of measurement at initial recognition for financial guarantee contracts provided for no consideration or for a consideration that is not a fair value. The IPSASB identified a valuation hierarchy that could be used in initially measuring a financial guarantee contract provided for no consideration or for consideration that is not a fair value:

- An entity assesses whether the fair value of the financial guarantee contract can be determined by observing a price in an active market;
- Where a price cannot be determined by observing a price in an active market, an entity uses a valuation technique; and
- If fair value cannot be determined for a financial guarantee contract, an entity measures a financial guarantee contract at initial recognition and subsequently in accordance with IPSAS 19.

BC19. There may be cases where an active market exists for financial guarantee contracts equivalent to or similar to that issued. In such cases a fair value should be estimated through observation of that active market. Where no active market exists, the IPSASB considered whether an entity should be required to move immediately to an approach based on IPSAS 19. The IPSASB noted that many valuation techniques are highly complex and, as noted in paragraphs AG107 and AG108 may give rise to a range of outcomes. It is arguable that the cost of developing such techniques exceeds the benefits to users of the information provided. An approach based on IPSAS 19 may provide a more reliable and understandable measure of an issuer's risk exposure as a result of entering into a financial guarantee contract. The IPSASB also acknowledged that where an entity does not recognize a liability in accordance with IPSAS 19, the entity makes the disclosures required for contingent liabilities in IPSAS 19 unless an outflow of resources is remote. The information provided to users on risk exposure related to financial guarantees provided at nil or nominal consideration also includes the credit risk disclosures in IPSAS 30, *Financial Instruments: Disclosures*. Conversely, the IPSASB acknowledged that there are current IPSASs that require the use of experts, such as actuaries, to develop valuation techniques that are inherently complex, such as IPSAS 39, *Employee Benefits*. On balance the IPSASB concluded that, in the absence of an active market, entities should be permitted to use a valuation technique that does not rely on an observable market where they are satisfied that such a technique provides a reliable and understandable method of determining a fair value for a financial guarantee contract entered into by an issuer by means of a non-exchange transaction. This is particularly the case for non-standard guarantees where there is limited data available on defaults and credit risk.

Revision of IPSAS 29 as a result of the IPSASB's *The Applicability of IPSASs*, issued in April 2016

BC20. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:

(a) Removes the standard paragraphs about the applicability of IPSASs to "public sector entities other than GBEs" from the scope section of each Standard;

(b) Replaces the term "GBE" with the term "commercial public sector entities", where appropriate; and

(c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.

Revision of IPSAS 29 as a result of *Improvements to IPSAS, 2021*

BC21. The IPSASB reviewed the revisions to IAS 39, *Financial Instruments: Recognition and Measurement*, included in *Interest Rate Benchmark Reform* (Amendments to IFRS 9, IAS 39 and IFRS 7) issued by the IASB in September 2019, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions and concurred that there was no public sector specific reason for not adopting these amendments, henceforth labeled as *Interest Rate Benchmark Reform*.

BC22. The IPSASB reviewed the revisions to IAS 39, *Financial Instruments: Recognition and Measurement, included in Interest Rate Benchmark Reform—Phase 2* (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16) issued by the IASB in August 2020, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions and concurred that there was no public sector specific reason for not adopting these amendments, henceforth labeled as *Interest Rate Benchmark Reform—Phase 2*.

BC23. In addition to the above amendments to IPSAS 29 (as amended by IPSAS 41 when it was first published in 2018), the IPSASB considered that entities still applying IPSAS 29 (prior to the adoption of IPSAS 41) could benefit from the amendments to the hedging section included in paragraphs 113A–113ZC of IPSAS 29 (as amended by IPSAS 41 when it was first published in 2018) and the amendments on the practical expedient for changes in the contractual cash flows of financial instruments included in paragraphs 72A–72E of IPSAS 41.

BC24. While the amendments in paragraphs 72A–72E of IPSAS 41 were unnecessary in the IASB's IPSAS 29 equivalent standard, IAS 39, they are necessary in IPSAS 29 (prior to the adoption of IPSAS 41) because the sections on contractual cash flows are effective until January 1, 2023.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 29.

Section A–G

[Deleted]

Illustrative Examples

These examples accompany, but are not part of, IPSAS 29.

Hedging Interest Rate Risk for a Portfolio of Assets and Liabilities

IE1. On January 1, 20X1 Entity A identifies a portfolio comprising assets and liabilities whose interest rate risk it wishes to hedge. The liabilities include demandable deposit liabilities that the depositor may withdraw at any time without notice. For risk management purposes, the entity views all of the items in the portfolio as fixed rate items.

IE2. For risk management purposes, Entity A analyzes the assets and liabilities in the portfolio into repricing time periods based on expected repricing dates. The entity uses monthly time periods and schedules items for the next five years (i.e., it has 60 separate monthly time periods).[2] The assets in the portfolio are prepayable assets that Entity A allocates into time periods based on the expected prepayment dates, by allocating a percentage of all of the assets, rather than individual items, into each time period. The portfolio also includes demandable liabilities that the entity expects, on a portfolio basis, to repay between one month and five years and, for risk management purposes, are scheduled into time periods on this basis. On the basis of this analysis, Entity A decides what amount it wishes to hedge in each time period.

IE4. This example deals only with the repricing time period expiring in three months' time, i.e., the time period maturing on March 31, 20X1 (a similar procedure would be applied for each of the other 59 time periods). Entity A has scheduled assets of CU100 million and liabilities of CU80 million into this time period. All of the liabilities are repayable on demand.

IE5. Entity A decides, for risk management purposes, to hedge the net position of CU20 million and accordingly enters into an interest rate swap[3] on January 1, 20X1, to pay a fixed rate and receive London Interbank Offered Rate (LIBOR), with a notional principal amount of CU20 million and a fixed life of three months.

IE7. This example makes the following simplifying assumptions:

(a) The coupon on the fixed leg of the swap is equal to the fixed coupon on the asset;

(b) The coupon on the fixed leg of the swap becomes payable on the same dates as the interest payments on the asset; and

(c) The interest on the variable leg of the swap is the overnight LIBOR rate. As a result, the entire fair value change of the swap arises from the fixed leg only, because the variable leg is not exposed to changes in fair value due to changes in interest rates.

In cases when these simplifying assumptions do not hold, greater ineffectiveness will arise. (The ineffectiveness arising from (a) could be eliminated by designating as the hedged item a portion of the cash flows on the asset that are equivalent to the fixed leg of the swap).

IE8. It is also assumed that Entity A tests effectiveness on a monthly basis.

IE9. The fair value of an equivalent non-prepayable asset of CU20 million, ignoring changes in value that are not attributable to interest rate movements, at various times during the period of the hedge is as follows:

	Jan 1, 20X1	**Jan 31, 20X1**	**Feb 1, 20X1**	**Feb 28, 20X1**	**Mar 31, 20X1**
Fair value (asset) (CU)	20,000,000	20,047,408	20,047,408	20,023,795	Nil

IE10. The fair value of the swap at various times during the period of the hedge is as follows:

	Jan 1, 20X1	**Jan 31, 20X1**	**Feb 1, 20X1**	**Feb-28, 20X1**	**Mar 31, 20X1**
Fair value (liability) (CU)	Nil	(47,408)	(47,408)	(23,795)	Nil

2 In this example principal cash flows have been scheduled into time periods but the related interest cash flows have been included when calculating the change in fair value of the hedged item. Other methods of scheduling assets and liabilities are also possible. Also, in this example, monthly repricing time periods have been used. An entity may choose narrower or wider time periods.

3 This example uses a swap as the hedging instrument. An entity may use forward rate agreements or other derivatives as hedging instruments.

Accounting Treatment

IE11. On January 1, 20X1, Entity A designates as the hedged item an amount of CU20 million of assets in the three-month time period. It designates as the hedged risk the change in the value of the hedged item (i.e., the CU20 million of assets) that is attributable to changes in LIBOR. It also complies with the other designation requirements set out in paragraphs 98(d) and AG162 of the Standard.

IE12. Entity A designates as the hedging instrument the interest rate swap described in paragraph IE4.

End of Month 1 (January 31, 20X1)

IE13. On January 31, 20X1 (at the end of month 1) when Entity A tests effectiveness, LIBOR has decreased. Based on historical prepayment experience, Entity A estimates that, as a consequence, prepayments will occur faster than previously estimated. As a result it re-estimates the amount of assets scheduled into this time period (excluding new assets originated during the month) as CU96 million.

IE14. The fair value of the designated interest rate swap with a notional principal of CU20 million is (CU47,408)[4] (the swap is a liability).

IE16. Entity A computes the change in the fair value of the hedged item, taking into account the change in estimated prepayments, as follows.

(a) First, it calculates the percentage of the initial estimate of the assets in the time period that was hedged. This is 20 percent (CU20 million ÷ CU100 million).

(b) Second, it applies this percentage (20 percent) to its revised estimate of the amount in that time period (CU96 million) to calculate the amount that is the hedged item based on its revised estimate. This is CU19.2 million.

(c) Third, it calculates the change in the fair value of this revised estimate of the hedged item (CU19.2 million) that is attributable to changes in LIBOR. This is CU45,511 (CU47,408[5] × (CU19.2 million ÷ CU20 million)).

IE17. Entity A makes the following accounting entries relating to this time period:

Dr		Cash	CU172,097	
	Cr	Surplus or deficit (interest revenue)[6]		CU172,097
To recognize the interest received on the hedged amount (CU19.2 million).				
Dr		Surplus or deficit (interest expense)	CU179,268	
	Cr	Surplus or deficit (interest revenue)		CU179,268
	Cr	Cash		Nil
To recognize the interest received and paid on the swap designated as the hedging instrument.				
Dr		Surplus or deficit (loss)	CU47,408	
	Cr	Derivative liability		CU47,408
To recognize the change in the fair value of the swap.				
Dr		Separate line item in the statement of financial position	CU45,511	
	Cr	Surplus or deficit (gain)		CU45,511
To recognize the change in the fair value of the hedged amount.				

IE19. The net result on surplus or deficit (excluding interest revenue and interest expense) is to recognize a loss of (CU1,897). This represents ineffectiveness in the hedging relationship that arises from the change in estimated prepayment dates.

Beginning of Month 2

IE20. On February 1, 20X1 Entity A sells a proportion of the assets in the various time periods. Entity A calculates that it has sold 81/3 percent of the entire portfolio of assets. Because the assets were allocated into time periods by allocating a percentage

4 See paragraph IE8.

5 i.e., CU20,047,408 – CU 20,000,000, see paragraph IE7.

6 This example does not show how amounts of interest revenue and interest expense are calculated.

of the assets (rather than individual assets) into each time period, Entity A determines that it cannot ascertain into which specific time periods the sold assets were scheduled. Hence it uses a systematic and rational basis of allocation. Based on the fact that it sold a representative selection of the assets in the portfolio, Entity A allocates the sale proportionately over all time periods.

IE21. On this basis, Entity A computes that it has sold 81/3 percent of the assets allocated to the three-month time period, i.e., CU8 million (81/3 percent of CU96 million). The proceeds received are CU8,018,400, equal to the fair value of the assets.[7] On derecognition of the assets, Entity A also removes from the separate line item in the statement of financial position an amount that represents the change in the fair value of the hedged assets that it has now sold. This is 81/3 percent of the total line item balance of CU45,511, i.e., CU3,793.

IE23. Entity A makes the following accounting entries to recognize the sale of the asset and the removal of part of the balance in the separate line item in the statement of financial position:

Dr		Cash	CU8,018,400	
	Cr	Asset		CU8,000,000
	Cr	Separate line item in the statement of financial position		CU3,793
	Cr	Surplus or deficit (gain)		CU14,607

To recognize the sale of the asset at fair value and to recognize a gain on sale

Because the change in the amount of the assets is not attributable to a change in the hedged interest rate, no ineffectiveness arises.

IE24. Entity A now has CU88 million of assets and CU80 million of liabilities in this time period. Hence the net amount Entity A wants to hedge is now CU8 million and, accordingly, it designates CU8 million as the hedged amount.

IE25. Entity A decides to adjust the hedging instrument by designating only a proportion of the original swap as the hedging instrument. Accordingly, it designates as the hedging instrument CU8 million or 40 percent of the notional amount of the original swap with a remaining life of two months and a fair value of CU18,963.[8] It also complies with the other designation requirements in paragraphs 98(a) and AG162 of the Standard. The CU12 million of the notional amount of the swap that is no longer designated as the hedging instrument is either classified as held for trading with changes in fair value recognized in surplus or deficit, or is designated as the hedging instrument in a different hedge.[9]

IE28. As at February 1, 20X1 and after accounting for the sale of assets, the separate line item in the statement of financial position is CU41,718 (CU45,511 – CU3,793), which represents the cumulative change in fair value of CU17.6[10] million of assets. However, as at February 1, 20X1, Entity A is hedging only CU8 million of assets that have a cumulative change in fair value of CU18,963.[11] The remaining separate line item in the statement of financial position of CU22,755[12] relates to an amount of assets that Entity A still holds but is no longer hedging. Accordingly Entity A amortizes this amount over the remaining life of the time period, i.e., it amortizes CU22,755 over two months.

IE32. Entity A determines that it is not practicable to use a method of amortization based on a recalculated effective yield and hence uses a straight-line method.

End of Month 2 (February 28, 20X1)

IE33. On February 28, 20X1 when Entity A next tests effectiveness, LIBOR is unchanged. Entity A does not revise its prepayment expectations. The fair value of the designated interest rate swap with a notional principal of CU8 million is (CU9,518)[13] (the swap is a liability). Also, Entity A calculates the fair value of the CU8 million of the hedged assets as at February 28, 20X1 as CU8,009,518.[14]

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7 The amount realized on sale of the asset is the fair value of a prepayable asset, which is less than the fair value of the equivalent non-prepayable asset shown in IE7.

8 CU47,408 × 40 percent.

9 The entity could instead enter into an offsetting swap with a notional principle of CU12 million to adjust its position and designate as the hedging instrument all CU20 million of the existing swap and all CU12 million of the new offsetting swap.

10 CU19.2 million – (8⅓ × CU19.2 million).

11 CU41,718 × (CU8 million/CU17.6 million).

12 CU41,718 – CU18,963.

13 CU23,795 [see paragraph IE8] × (CU8 million/CU20 million).

14 CU20,023,795 [see paragraph IE7] × (CU8 million/CU20 million).

IE36. Entity A makes the following accounting entries relating to the hedge in this time period:

Dr		Cash	CU71,707	
	Cr	Surplus or deficit (interest revenue)		CU71,707

To recognize the interest received on the hedged amount (CU8 million).

Dr		Surplus or deficit (interest expense)	CU71,707	
	Cr	Surplus or deficit(interest revenue)		CU62,115
	Cr	Cash		CU9,592

To recognize the interest received and paid on the portion of the swap designated as the hedging instrument (CU8 million).

Dr		Derivative liability	CU9,445	
	Cr	Surplus or deficit (gain)		CU9,445

To recognize the change in the fair value of the portion of the swap designated as the hedging instrument (CU8 million) (CU9,518 – CU18,963).

Dr		Surplus or deficit (loss)	CU9,445	
	Cr	Separate line item in the statement of financial position		CU9,445

To recognize the change in the fair value of the hedged amount (CU8,009,518 – CU8,018,963).

IE37. The net effect on surplus or deficit (excluding interest revenue and interest expense) is nil reflecting that the hedge is fully effective.

IE38. Entity A makes the following accounting entry to amortize the line item balance for this time period:

Dr		Surplus or deficit (loss)	CU11,378	
	Cr	Separate line item in the statement of financial position		CU11,378 (a)

To recognize the amortization charge for the period.

(a) CU22,755 ÷ 2

End of Month 3

IE39. During the third month there is no further change in the amount of assets or liabilities in the three-month time period. On March 31, 20X1 the assets and the swap mature and all balances are recognized in surplus or deficit.

IE40. Entity A makes the following accounting entries relating to this time period:

Dr		Cash	CU8,071,707	
	Cr	Asset (statement of financial position)		CU8,000,000
	Cr	Surplus or deficit (interest revenue)		CU71,707

To recognize the interest and cash received on maturity of the hedged amount (CU8 million).

Dr		Surplus or deficit (interest expense)	CU71,707	
	Cr	Surplus or deficit (interest-revenue)		CU62,115
	Cr	Cash		CU9,592

To recognize the interest received and paid on the portion of the swap designated as the hedging instrument (CU8 million).

Dr		Derivative liability	CU9,518	
	Cr	Surplus or deficit (gain)		CU9,518

To recognize the expiry of the portion of the swap designated as the hedging instrument (CU8 million).

Dr		Surplus or deficit (loss)	CU9,518	
	Cr	Separate line item in the statement of financial position		CU9,518

To remove the remaining line item balance on expiry of the time period.

IE42. The net effect on surplus or deficit (excluding interest revenue and interest expense) is nil reflecting that the hedge is fully effective.

IE43. Entity A makes the following accounting entry to amortize the line item balance for this time period:

Dr		Surplus or deficit (loss)	CU11,377	
	Cr	Separate line item in the statement of financial position		CU11,377[(a)]

To recognize the amortization charge for the period.

(a) CU22,755 ÷ 2

Summary

IE44. The tables below summarize:

(a) Changes in the separate line item in the statement of financial position;

(b) The fair value of the derivative;

(c) The surplus or deficit effect of the hedge for the entire three-month period of the hedge; and

(d) Interest revenue and interest expense relating to the amount designated as hedged.

Description	**Jan 1, 20X1**	**Jan 31, 20X1**	**Feb 1, 20X1**	**Feb 28, 20X1**	**Mar 31, 20X1**
	CU	**CU**	**CU**	**CU**	**CU**
Amount of asset hedged	**20,000,000**	**19,200,000**	**8,000,000**	**8,000,000**	**8,000,000**
(a) **Changes in the separate line item in the statement of financial position**					
Brought forward:					
Balance to be amortized	Nil	Nil	Nil	22,755	11,377
Remaining balance	Nil	Nil	45,511	18,963	9,518
Less: Adjustment on sale of asset	Nil	Nil	(3,793)	Nil	Nil
Adjustment for change in fair value of the hedged asset	Nil	45,511	Nil	(9,445)	(9,518)
Amortization	Nil	Nil	Nil	(11,378)	(11,377)
Carried forward:					
Balance to be amortized	**Nil**	**Nil**	**22,755**	**11,377**	**Nil**
Remaining balance	**Nil**	**45,511**	**18,963**	**9,518**	**Nil**
(b) **The fair value of the derivative**					
CU20,000,000	Nil	47,408	–	–	–
CU12,000,000	Nil	–	28,445	No longer designated as the hedging instrument.	
CU8,000,000	Nil	–	18,963	9,518	Nil
Total	**Nil**	**47,408**	**47,408**	**9,518**	**Nil**
(c) **Effect of the hedge on surplus or deficit**					
Change in line item: asset	Nil	45,511	N/A	(9,445)	(9,518)
Change in derivative fair value	Nil	(47,408)	N/A	9,445	9,518
Net effect	**Nil**	**(1,897)**	**N/A**	**Nil**	**Nil**
Amortization	**Nil**	**Nil**	**N/A**	**(11,378)**	**(11,377)**
In addition, there is a gain on sale of assets of CU14,607 at February 1, 20X1.					
(d) **Interest revenue and interest expense relating to the amount designated as hedged**					
Interest revenue					
– on the asset	Nil	172,097	N/A	71,707	71,707
– on the swap	Nil	179,268	N/A	62,115	62,115
Interest expense					
– on the swap	Nil	(179,268)	N/A	(71,707)	(71,707)

IE32–IE50. [Deleted]

Comparison with IAS 39

IPSAS 29, *Financial Instruments: Recognition and Measurement* is drawn primarily from IAS 39, *Financial Instruments: Recognition and Measurement* (including amendments up to December 31, 2008 as well as amendments made by the IASB to IAS 39 as part of its *Improvements to IFRSs* in April 2009). The main differences between IPSAS 29 and IAS 39 are as follows:

- IPSAS 29 contains additional application guidance to deal with concessionary loans and financial guarantee contracts entered into at nil or nominal consideration. IAS 39 does not deal with these areas.
- In certain instances, IPSAS 29 uses different terminology from IAS 39. The most significant examples are the use of the terms "statement of financial performance" and "net assets/equity." The equivalent terms in IAS 39 are "statement of comprehensive income or separate income statement (if presented)" and "equity."
- IPSAS 29 does not distinguish between "revenue" and "income." IAS 39 distinguishes between "revenue and "income," with "income" having a broader meaning than the term "revenue."
- Principles from IFRIC 9, *Reassessment of Embedded Derivatives* and IFRIC 16 *Hedges of a Net Investment in a Foreign Operation* have been included as authoritative appendices to IPSAS 29. The IASB issues IFRICs as separate documents.

IPSAS 30—FINANCIAL INSTRUMENTS: DISCLOSURES

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Financial Reporting Standard (IFRS) 7, *Financial Instruments: Disclosures* published by the International Accounting Standards Board (IASB). Extracts from IFRS 7 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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IPSAS 30—FINANCIAL INSTRUMENTS: DISCLOSURES

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 30, *Financial Instruments: Disclosures* was issued in January 2010.

Since then, IPSAS 30 has been amended by the following IPSASs:

- IPSAS 43, *Leases* (issued January 2022)
- *Improvements to IPSAS 2021* (issued January 2022)
- *COVID-19: Deferral of Effective Dates* (issued November 2020)
- *Improvements to IPSAS 2019* (issued January 2020)
- IPSAS 41, *Financial Instruments* (issued August 2018)
- IPSAS 39, *Employee Benefits* (issued July 2016)
- *The Applicability of IPSASs* (issued April 2016)
- *Improvements to IPSASs 2015* (issued April 2016)
- IPSAS 38, *Disclosure of Interests in Other Entities* (issued January 2015)
- IPSAS 37, *Joint Arrangements* (issued January 2015)
- IPSAS 35, *Consolidated Financial Statements* (issued January 2015)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2011* (issued October 2011)

Table of Amended Paragraphs in IPSAS 30

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
2	Amended	IPSAS 41 August 2018
3	Amended	IPSAS 35 January 2015 IPSAS 37 January 2015 IPSAS 39 July 2016 IPSAS 41 August 2018
4	Amended	IPSAS 41 August 2018
5	Amended	IPSAS 41 August 2018
5A	New	IPSAS 41 August 2018
6	Deleted	The Applicability of IPSASs April 2016
7	Deleted	The Applicability of IPSASs April 2016
8	Amended	IPSAS 41 August 2018
11	Amended	IPSAS 41 August 2018
12	Amended	IPSAS 41 August 2018
13	Amended	IPSAS 41 August 2018
13A	New	IPSAS 41 August 2018
14	Amended	IPSAS 41 August 2018

Paragraph Affected	How Affected	Affected By
Heading above paragraph 14A	New	IPSAS 41 August 2018
14A	New	IPSAS 41 August 2018
14B	New	IPSAS 41 August 2018
15	Deleted	IPSAS 41 August 2018
15A	New	IPSAS 41 August 2018
15B	New	IPSAS 41 August 2018
15C	New	IPSAS 41 August 2018
16	Deleted	IPSAS 41 August 2018
Heading above paragraph 17	Deleted	IPSAS 41 August 2018
17	Deleted	IPSAS 41 August 2018
Heading above paragraph 17A	New	IPSAS 41 August 2018
17A	New	IPSAS 41 August 2018
17B	New	IPSAS 41 August 2018
17C	New	IPSAS 41 August 2018
17D	New	IPSAS 41 August 2018
17E	New	IPSAS 41 August 2018
17F	New	IPSAS 41 August 2018
18	Amended	IPSAS 41 August 2018
20	Deleted	IPSAS 41 August 2018
20A	New	IPSAS 41 August 2018
24	Amended	IPSAS 41 August 2018
24A	New	IPSAS 41 August 2018
25A	New	IPSAS 41 August 2018
25B	New	IPSAS 41 August 2018
25C	New	IPSAS 41 August 2018
25D	New	IPSAS 41 August 2018
26	Deleted	IPSAS 41 August 2018
Heading above paragraph 26A	New	IPSAS 41 August 2018
26A	New	IPSAS 41 August 2018
26B	New	IPSAS 41 August 2018
26C	New	IPSAS 41 August 2018
Heading above paragraph 27	New	IPSAS 41 August 2018
27	Deleted	IPSAS 41 August 2018
27A	New	IPSAS 41 August 2018
27B	New	IPSAS 41 August 2018
27C	New	IPSAS 41 August 2018
27D	New	IPSAS 41 August 2018
27E	New	IPSAS 41 August 2018
27F	New	IPSAS 41 August 2018
Heading above paragraph 28	New	IPSAS 41 August 2018

Paragraph Affected	How Affected	Affected By
28	Deleted	IPSAS 41 August 2018
28A	New	IPSAS 41 August 2018
28B	New	IPSAS 41 August 2018
28C	New	IPSAS 41 August 2018
28D	New	IPSAS 41 August 2018
28E	New	IPSAS 41 August 2018
28F	New	IPSAS 41 August 2018
Heading above paragraph 28G	New	IPSAS 41 August 2018
28G	New	IPSAS 41 August 2018
Heading above paragraph 28H	New	Improvements to IPSAS January 2022
28H	New	Improvements to IPSAS January 2022
Heading above paragraph 28I	New	Improvements to IPSAS January 2022
28I	New	Improvements to IPSAS January 2022
28J	New	Improvements to IPSAS January 2022
34	Amended	IPSAS 41 August 2018
35	Amended	IPSAS 41 August 2018 IPSAS 43 January 2022
36	Amended	IPSAS 41 August 2018
37	Amended	IPSAS 41 August 2018
37A	New	IPSAS 41 August 2018
39A	New	IPSAS 41 August 2018
41	Amended	IPSAS 41 August 2018
Heading above paragraph 42A	New	IPSAS 41 August 2018
42A	New	IPSAS 41 August 2018
42B	New	IPSAS 41 August 2018
42C	New	IPSAS 41 August 2018
42D	New	IPSAS 41 August 2018
42E	New	IPSAS 41 August 2018
Heading above paragraph 42F	New	IPSAS 41 August 2018
42F	New	IPSAS 41 August 2018
42G	New	IPSAS 41 August 2018
Heading above paragraph 42H	New	IPSAS 41 August 2018
42H	New	IPSAS 41 August 2018
42I	New	IPSAS 41 August 2018
42J	New	IPSAS 41 August 2018
42K	New	IPSAS 41 August 2018
42L	New	IPSAS 41 August 2018
Heading above paragraph 42M	New	IPSAS 41 August 2018
42M	New	IPSAS 41 August 2018
42N	New	IPSAS 41 August 2018

Paragraph Affected	How Affected	Affected By
43	Amended	IPSAS 41 August 2018
Heading above paragraph 44	Deleted	IPSAS 41 August 2018
44	Deleted	IPSAS 41 August 2018
45	Amended	IPSAS 41 August 2018
Heading above paragraph 49A	New	IPSAS 41 August 2018
49A	New	IPSAS 41 August 2018
49B	New	IPSAS 41 August 2018
49C	New	IPSAS 41 August 2018
Heading above paragraph 49D	New	IPSAS 41 August 2018
49D	New	IPSAS 41 August 2018
Heading above paragraph 49E	New	IPSAS 41 August 2018
49E	New	IPSAS 41 August 2018
49F	New	IPSAS 41 August 2018
49G	New	IPSAS 41 August 2018
Heading above paragraph 49H	New	IPSAS 41 August 2018
49H	New	IPSAS 41 August 2018
Heading above paragraph 49I	New	IPSAS 41 August 2018
49I	New	IPSAS 41 August 2018
49J	New	IPSAS 41 August 2018
49K	New	IPSAS 41 August 2018
49L	New	IPSAS 41 August 2018
49M	New	IPSAS 41 August 2018
49N	New	IPSAS 41 August 2018
49O	New	IPSAS 41 August 2018
49P	New	IPSAS 41 August 2018
49Q	New	IPSAS 41 August 2018
49R	New	IPSAS 41 August 2018
49S	New	IPSAS 41 August 2018
52A	New	IPSAS 33 January 2015
52B	New	IPSAS 38 January 2015 IPSAS 37 January 2015 IPSAS 35 January 2015
52C	New	Improvements to IPSASs April 2016
52D	New	The Applicability of IPSASs April 2016
52E	New	IPSAS 39 July 2016
52F	Amended	COVID-19: Deferral of Effective Dates November 2020
52G	Amended	COVID-19: Deferral of Effective Dates November 2020
52H	New	Improvements to IPSAS January 2022

Paragraph Affected	How Affected	Affected By
52I	New	Improvements to IPSAS January 2022
52J	New	Improvements to IPSAS January 2022
52K	New	Improvements to IPSAS January 2022
52L	New	IPSAS 43 January 2022
53	Amended	IPSAS 33 January 2015
AG1	Amended	IPSAS 41 August 2018
Headings above paragraph AG4	Deleted	IPSAS 41 August 2018
AG4	Deleted	IPSAS 41 August 2018
AG5	Amended	Improvements to IPSAS January 2020 IPSAS 41 August 2018
AG6	Amended	IPSAS 38 January 2015
Heading above paragraph AG8A	New	IPSAS 41 August 2018
AG8A	New	IPSAS 41 August 2018
AG8B	New	IPSAS 41 August 2018
AG8C	New	IPSAS 41 August 2018
Heading above paragraph AG8D	New	IPSAS 41 August 2018
AG8D	New	IPSAS 41 August 2018
AG8E	New	IPSAS 41 August 2018
Heading above paragraph AG8F	New	IPSAS 41 August 2018
AG8F	New	IPSAS 41 August 2018
AG8G	New	IPSAS 41 August 2018
Heading above paragraph AG8H	New	IPSAS 41 August 2018
AG8H	New	IPSAS 41 August 2018
AG8I	New	IPSAS 41 August 2018
AG8J	New	IPSAS 41 August 2018
AG9	Amended	IPSAS 41 August 2018
AG10	Amended	IPSAS 41 August 2018
AG16	Amended	IPSAS 43 January 2022
AG24	Amended	IPSAS 41 August 2018
AG29	Amended	IPSAS 41 August 2018
Headings above paragraph AG31	New	IPSAS 41 August 2018
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AG32	New	IPSAS 41 August 2018
AG32A	New	IPSAS 41 August 2018
AG33	New	IPSAS 41 August 2018
Heading above paragraph AG34	New	IPSAS 41 August 2018
AG34	New	IPSAS 41 August 2018
Heading above paragraph AG35	New	IPSAS 41 August 2018
AG35	New	IPSAS 41 August 2018
Heading above paragraph AG36	New	IPSAS 41 August 2018

Paragraph Affected	How Affected	Affected By
AG36	New	IPSAS 41 August 2018
AG37	New	IPSAS 41 August 2018
AG38	New	IPSAS 41 August 2018
Heading above paragraph AG39	New	IPSAS 41 August 2018
AG39	New	IPSAS 41 August 2018
Heading above paragraph AG40	New	IPSAS 41 August 2018
AG40	New	IPSAS 41 August 2018
Heading above paragraph AG41	New	IPSAS 41 August 2018
AG41	New	IPSAS 41 August 2018
Headings above paragraph AG42	New	IPSAS 41 August 2018
AG42	New	IPSAS 41 August 2018
AG43	New	IPSAS 41 August 2018
Heading above paragraph AG44	New	IPSAS 41 August 2018
AG44	New	IPSAS 41 August 2018
Heading above paragraph AG45	New	IPSAS 41 August 2018
AG45	New	IPSAS 41 August 2018
Heading above paragraph AG46	New	IPSAS 41 August 2018
AG46	New	IPSAS 41 August 2018
Heading above paragraph AG47	New	IPSAS 41 August 2018
AG47	New	IPSAS 41 August 2018
AG48	New	IPSAS 41 August 2018
Heading above paragraph AG49	New	IPSAS 41 August 2018
AG49	New	IPSAS 41 August 2018
AG50	New	IPSAS 41 August 2018
Heading above paragraph AG51	New	IPSAS 41 August 2018
AG51	New	IPSAS 41 August 2018
Heading above paragraph AG52	New	IPSAS 41 August 2018
AG52	New	IPSAS 41 August 2018
Heading above paragraph AG53	New	IPSAS 41 August 2018
AG53	New	IPSAS 41 August 2018
AG54	New	IPSAS 41 August 2018
Heading above paragraph AG55	New	IPSAS 41 August 2018
AG55	New	IPSAS 41 August 2018
BC12	New	Improvements to IPSAS January 2022
BC13	New	Improvements to IPSAS January 2022
Heading above paragraph IG3	Deleted	IPSAS 41 August 2018
IG3	Deleted	IPSAS 41 August 2018
IG4	Deleted	IPSAS 41 August 2018
Heading above paragraph IG7	Deleted	IPSAS 41 August 2018
IG7	Deleted	IPSAS 41 August 2018

Paragraph Affected	How Affected	Affected By
IG8	Deleted	IPSAS 41 August 2018
IG9	Deleted	IPSAS 41 August 2018
IG10	Deleted	IPSAS 41 August 2018
IG11	Deleted	IPSAS 41 August 2018
Heading above paragraph IG13A	New	Improvements to IPSAS January 2020
IG13A	New	Improvements to IPSAS January 2020
IG13B	New	Improvements to IPSAS January 2020
IG13C	New	Improvements to IPSAS January 2020
IG14	Amended	IPSAS 41 August 2018
IG15	Amended	IPSAS 41 August 2018
IG16	Amended	IPSAS 41 August 2018
Heading above paragraph IG22A	New	Improvements to IPSAS January 2020
IG22A	New	Improvements to IPSAS January 2020
Heading above paragraph IG22B	New	Improvements to IPSAS January 2020
IG22B	New	Improvements to IPSAS January 2020
Heading above paragraph IG22C	New	Improvements to IPSAS January 2020
IG22C	New	Improvements to IPSAS January 2020
IG22D	New	Improvements to IPSAS January 2020
IG23	Amended	Improvements to IPSAS January 2020
Heading above paragraph IG25	Deleted	IPSAS 41 August 2018
IG25	Deleted	IPSAS 41 August 2018
IG26	Deleted	IPSAS 41 August 2018
IG27	Deleted	IPSAS 41 August 2018
Heading above paragraph IG28	Deleted	IPSAS 41 August 2018
IG28	Deleted	IPSAS 41 August 2018
IG29	Deleted	IPSAS 41 August 2018
IG30	Deleted	IPSAS 41 August 2018
IG31	Deleted	IPSAS 41 August 2018
IG36	Amended	IPSAS 41 August 2018
Heading above paragraph IG41	New	IPSAS 41 August 2018
IG41	New	IPSAS 41 August 2018
IG42	New	IPSAS 41 August 2018
IG43	New	IPSAS 41 August 2018
Heading above paragraph IG44	New	IPSAS 41 August 2018
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IG45	New	IPSAS 41 August 2018

IPSAS 30—FINANCIAL INSTRUMENTS: DISCLOSURES

CONTENTS

International Public Sector Accounting Standard 30, *Financial Instruments: Disclosures*, is set out in paragraphs 1–54. All the paragraphs have equal authority. IPSAS 30 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to require entities to provide disclosures in their financial statements that enable users to evaluate:

   (a) The significance of financial instruments for the entity's financial position and performance; and

   (b) The nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

2. The principles in this Standard complement the principles for recognizing, measuring, and presenting financial assets and financial liabilities in IPSAS 28, *Financial Instruments: Presentation* and IPSAS 41, *Financial Instruments*.

Scope

3. **This Standard shall be applied by all entities to all types of financial instruments, except:**

   (a) **Those interests in controlled entities, associates, or joint ventures that are accounted for in accordance with IPSAS 34, *Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements* or IPSAS 36, *Investments in Associates and Joint Ventures*. However, in some cases, IPSAS 34, IPSAS 35, or IPSAS 36 require or permit an entity to account for an interest in a controlled entity, associate, or joint venture using IPSAS 41; in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in controlled entities, associates, or joint ventures unless the derivative meets the definition of an equity instrument in IPSAS 28.**

   (b) **Employers' rights and obligations arising from employee benefit plans, to which IPSAS 39, *Employee Benefits* applies.**

   (c) **Rights and obligations arising under insurance contracts. However, this Standard applies to:**

      (i) **Derivatives that are embedded in insurance contracts if IPSAS 41 requires the entity to account for them separately; and**

      (ii) **An issuer of financial guarantee contracts if the issuer applies IPSAS 41 in recognizing and measuring the contracts, but shall apply the relevant international or national accounting standard dealing with insurance contracts if the issuer elects to apply those standards in recognizing and measuring them.**

      In addition to (i) and (ii) above, an entity may apply this Standard to insurance contracts which involve the transfer of financial risk.

   (d) **Financial instruments, contracts, and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share-based payment applies, except for contracts within the scope of paragraphs 6–8 of IPSAS 41, to which that Standard applies.**

   (e) **Instruments that are required to be classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18 of IPSAS 28.**

4. This Standard applies to recognized and unrecognized financial instruments. Recognized financial instruments include financial assets and financial liabilities that are within the scope of IPSAS 41. Unrecognized financial instruments include some financial instruments that, although outside the scope of IPSAS 41, are within the scope of this Standard (such as some loan commitments).

5. This Standard applies to contracts to buy or sell a non-financial item that are within the scope of IPSAS 41 (see paragraphs 6–8 of IPSAS 41).

5A. The credit risk disclosure requirements in paragraphs 42A–42N apply to those rights for receivables that result from exchange transactions that are within the scope of IPSAS 9 and non-exchange transactions within the scope of IPSAS 23 which give rise to financial instruments for the purpose of recognizing impairment gains or losses in accordance with paragraph 3 of IPSAS 41. Any reference to financial assets or financial instruments in these paragraphs shall include those rights unless otherwise specified.

6. [Deleted]

7. [Deleted]

Definitions

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

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

Credit risk rating grades is a rating of credit risk based on the risk of a default occurring on the financial instrument.

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

Loans payable are financial liabilities, other than short-term trade payables on normal credit terms.

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk, and other price risk.

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.

Classes of Financial Instruments and Level of Disclosure

9. When this Standard requires disclosures by class of financial instrument, an entity shall group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. An entity shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position.

Significance of Financial Instruments for Financial Position and Financial Performance

10. **An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance.**

Statement of Financial Position

Categories of Financial Assets and Financial Liabilities

11. The carrying amounts of each of the following categories, as defined in IPSAS 41, shall be disclosed either in the statement of financial position or in the notes:

(a) Financial assets measured at fair value through surplus or deficit, showing separately (i) those designated as such upon initial recognition or subsequently in accordance with paragraph 152 of IPSAS 41, and (ii) those mandatorily measured at fair value through surplus or deficit in accordance with IPSAS 41;

(b) [Deleted]

(c) [Deleted]

(d) [Deleted]

(e) Financial liabilities at fair value through surplus or deficit, showing separately (i) those designated as such upon initial recognition or subsequently in accordance with paragraph 152 of IPSAS 41, and (ii) those that meet the definition of held for trading in IPSAS 41;

(f) Financial assets measured at amortized cost;

(g) Financial liabilities measured at amortized cost; and

(h) Financial assets measured at fair value through net assets/equity, showing separately (i) financial assets that are measured at fair value through net assets/equity in accordance with paragraph 41 of IPSAS 41; and (ii) investments in equity instruments designated as such upon initial recognition in accordance with paragraph 106 of IPSAS 41.

Financial Assets or Financial Liabilities at Fair Value through Surplus or Deficit

12. If the entity has designated as measured at fair value through surplus or deficit a financial asset (or group of financial assets) that would otherwise be measured at fair value through net assets/equity or amortized cost, it shall disclose:

(a) The maximum exposure to credit risk (see paragraph 43(a)) of the financial asset (or group of financial assets) at the end of the reporting period.

(b) The amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk (see paragraph 43(b)).

(c) The amount of change, during the period and cumulatively, in the fair value of the financial asset (or group of financial assets) that is attributable to changes in the credit risk of the financial asset determined either:

(i) As the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk; or

(ii) Using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the asset.

Changes in market conditions that give rise to market risk include changes in an observed (benchmark) interest rate, commodity price, foreign exchange rate, or index of prices or rates.

(d) The amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the financial asset was designated.

13. If the entity has designated a financial liability as at fair value through surplus or deficit in accordance with paragraph 46 of IPSAS 41 and is required to present the effects of changes in that liability's credit risk in net assets/equity (see paragraph 108 of IPSAS 41), it shall disclose:

(a) The amount of change, cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability (see paragraphs AG236–AG243 of IPSAS 41 for guidance on determining the effects of changes in a liability's credit risk);

(b) The difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

(c) Any transfers of the cumulative gain or loss within net assets/equity during the period including the reason for such transfers.

(d) If a liability is derecognized during the period, the amount (if any) presented in net assets/equity that was realized at derecognition.

13A. If an entity has designated a financial liability as at fair value through surplus or deficit in accordance with paragraph 46 of IPSAS 41 and is required to present all changes in the fair value of that liability (including the effects of changes in the credit risk of the liability) in surplus or deficit (see paragraphs 108 and 109 of IPSAS 41), it shall disclose:

(a) The amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability (see paragraphs AG236–AG243 of IPSAS 41 for guidance on determining the effects of changes in a liability's credit risk); and

(b) The difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

14. The entity shall also disclose:

(a) A detailed description of the methods used to comply with the requirements in paragraphs 12(c), 13(a) and 13A(a) and paragraph 108(a) of IPSAS 41, including an explanation of why the method is appropriate.

(b) If the entity believes that the disclosure it has given, either in the statement of financial position or in the notes, to comply with the requirements in paragraph 12(c), 13(a) or 13A(a) or paragraph 108(a) of IPSAS 41 does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant.

(c) A detailed description of the methodology or methodologies used to determine whether presenting the effects of changes in a liability's credit risk in net assets/equity would create or enlarge an accounting mismatch in surplus or deficit (see paragraphs 108 and 109 of IPSAS 41). If an entity is required to present the effects of changes in a liability's credit risk in surplus or deficit (see paragraph 109 of IPSAS 41), the disclosure must include a detailed description of the economic relationship described in paragraph AG229 of IPSAS 41.

Investments in Equity Instruments Designated at Fair Value through Net Assets/Equity

14A. If an entity has designated investments in equity instruments to be measured at fair value through net assets/equity, as permitted by paragraph 106 of IPSAS 41, it shall disclose:

(a) Which investments in equity instruments have been designated to be measured at fair value through net assets/equity.

(b) The reasons for using this presentation alternative.

(c) The fair value of each such investment at the end of the reporting period.

(d) Dividends recognized during the period, showing separately those related to investments derecognized during the reporting period and those related to investments held at the end of the reporting period.

(e) Any transfers of the cumulative gain or loss within net assets/equity during the period including the reason for such transfers.

14B. If an entity derecognized investments in equity instruments measured at fair value through net assets/equity during the reporting period, it shall disclose:

(a) The reasons for disposing of the investments.

(b) The fair value of the investments at the date of derecognition.

(c) The cumulative gain or loss on disposal.

Reclassification

15. [Deleted]

15A. An entity shall disclose if, in the current or previous reporting periods, it has reclassified any financial assets in accordance with paragraph 54 of IPSAS 41. For each such event, an entity shall disclose:

(a) The date of reclassification.

(b) A detailed explanation of the change in management model and a qualitative description of its effect on the entity's financial statements.

(c) The amount reclassified into and out of each category.

15B. For each reporting period following reclassification until derecognition, an entity shall disclose for assets reclassified out of the fair value through surplus or deficit category so that they are measured at amortized cost or fair value through net assets/equity in accordance with paragraph 54 of IPSAS 41:

(a) The effective interest rate determined on the date of reclassification; and

(b) The interest revenue recognized.

15C. If, since its last reporting date, an entity has reclassified financial assets out of the fair value through net assets/equity category so that they are measured at amortized cost or out of the fair value through surplus or deficit category so that they are measured at amortized cost or fair value through net assets/equity it shall disclose:

(a) The fair value of the financial assets at the end of the reporting period; and

(b) The fair value gain or loss that would have been recognized in surplus or deficit or net assets/equity during the reporting period if the financial assets had not been reclassified.

16. [Deleted]

17. [Deleted]

Offsetting Financial Assets and Financial Liabilities

17A. The disclosures in paragraphs 17B–17E supplement the other disclosure requirements of this Standard and are required for all recognized financial instruments that are set off in accordance with paragraph 47 of IPSAS 28. These disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with paragraph 47 of IPSAS 28.

17B. An entity shall disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on the entity's financial position. This includes the effect or potential effect of rights of set-off associated with the entity's recognized financial assets and recognized financial liabilities that are within the scope of paragraph 17A.

17C. To meet the objective in paragraph 17B, an entity shall disclose, at the end of the reporting period, the following quantitative information separately for recognized financial assets and recognized financial liabilities that are within the scope of paragraph 17A:

(a) The gross amounts of those recognized financial assets and recognized financial liabilities;

(b) The amounts that are set off in accordance with the criteria in paragraph 47 of IPSAS 28 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 17C(b), including:

(i) Amounts related to recognized financial instruments that do not meet some or all of the offsetting criteria in paragraph 47 of IPSAS 28; 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.

The information required by this paragraph shall be presented in a tabular format, separately for financial assets and financial liabilities, unless another format is more appropriate.

17D. The total amount disclosed in accordance with paragraph 17C(d) for an instrument shall be limited to the amount in paragraph 17C(c) for that instrument.

17E. An entity shall include a description in the disclosures of the rights of set-off associated with the entity's recognized financial assets and recognized financial liabilities subject to enforceable master netting arrangements and similar agreements that are disclosed in accordance with paragraph 17C(d), including the nature of those rights.

17F. If the information required by paragraphs 17B–17E is disclosed in more than one note to the financial statements, an entity shall cross-refer between those notes.

Collateral

18. An entity shall disclose:

(a) The carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with paragraph 34(a) of IPSAS 41; and

(b) The terms and conditions relating to its pledge.

19. When an entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it shall disclose:

(a) The fair value of the collateral held;

(b) The fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and

(c) The terms and conditions associated with its use of the collateral.

Allowance Account for Credit Losses

20. [Deleted]

20A. The carrying amount of financial assets measured at fair value through net assets/equity in accordance with paragraph 41 of IPSAS 41 is not reduced by a loss allowance and an entity shall not present the loss allowance separately in the statement of financial position as a reduction of the carrying amount of the financial asset. However, an entity shall disclose the loss allowance in the notes to the financial statements.

Compound Financial Instruments with Multiple Embedded Derivatives

21. If an entity has issued an instrument that contains both a liability and an equity component (see paragraph 33 of IPSAS 28) and the instrument has multiple embedded derivatives whose values are interdependent (such as a callable convertible debt instrument), it shall disclose the existence of those features.

Defaults and Breaches

22. For loans payable recognized at the end of the reporting period, an entity shall disclose:

(a) Details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable;

(b) The carrying amount of the loans payable in default at the end of the reporting period; and

(c) Whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorized for issue.

23. If, during the period, there were breaches of loan agreement terms other than those described in paragraph 22, an entity shall disclose the same information as required by paragraph 22 if those breaches permitted the lender to demand accelerated repayment (unless the breaches were remedied, or the terms of the loan were renegotiated, on or before the end of the reporting period).

Statement of Financial Performance

Items of Revenue, Expense, Gains, or Losses

24. An entity shall disclose the following items of revenue, expense, gains, or losses either in the statement of financial performance or in the notes:

(a) Net gains or net losses on:

(i) Financial assets or financial liabilities measured at fair value through surplus or deficit, showing separately those on financial assets or financial liabilities designated as such upon initial recognition or subsequently in accordance with paragraph 152 of IPSAS 41, and those on financial assets or financial liabilities that are mandatorily measured at fair value through surplus or deficit in accordance with IPSAS 41 (e.g., financial liabilities that meet the definition of held for trading in IPSAS 41). For financial liabilities designated as at fair value through surplus or deficit, an entity shall show separately the amount of gain or loss recognized in net assets/equity and the amount recognized in surplus or deficit;

(ii) [Deleted]

(iii) [Deleted]

(iv) [Deleted]

(v) Financial liabilities measured at amortized cost;

(vi) Financial assets measured at amortized cost;

(vii) Investments in equity instruments designated at fair value through net assets/equity in accordance with paragraph 106 of IPSAS 41; and

(viii) Financial assets measured at fair value through net assets/equity in accordance with paragraph 41 of IPSAS 41, showing separately the amount of gain or loss recognized in net assets/equity during the period and the amount reclassified upon derecognition from accumulated net assets/equity to surplus or deficit for the period.

(b) Total interest revenue and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are measured at amortized cost or that are measured at fair value through net assets/equity in accordance with paragraph 41 of IPSAS 41 (showing these amounts separately); or financial liabilities that are not measured at fair value through surplus or deficit;

(c) Fee revenue and expense (other than amounts included in determining the effective interest rate) arising from:

(i) Financial assets or financial liabilities that are not at fair value through surplus or deficit; and

(ii) Trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions;

(d) [Deleted]

(e) [Deleted]

24A. An entity shall disclose an analysis of the gain or loss recognized in the statement of financial performance arising from the derecognition of financial assets measured at amortized cost, showing separately gains and losses arising from derecognition of those financial assets. This disclosure shall include the reasons for derecognizing those financial assets.

Other Disclosures

Accounting Policies

25. In accordance with paragraph 132 of IPSAS 1, an entity discloses, in the summary of significant accounting policies, the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements.

Hedge Accounting

25A. An entity shall apply the disclosure requirements in paragraphs 25B–28F for those risk exposures that an entity hedges and for which it elects to apply hedge accounting. Hedge accounting disclosures shall provide information about:

(a) An entity's risk management strategy and how it is applied to manage risk;

(b) How the entity's hedging activities may affect the amount, timing and uncertainty of its future cash flows; and

(c) The effect that hedge accounting has had on the entity's statement of financial position, statement of financial performance and statement of changes in net assets/equity.

25B. An entity shall present the required disclosures in a single note or separate section in its financial statements. However, an entity need not duplicate information that is already presented elsewhere, provided that the information is incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.

25C. When paragraphs 26A–28F require the entity to separate by risk category the information disclosed, the entity shall determine each risk category on the basis of the risk exposures an entity decides to hedge and for which hedge accounting is applied. An entity shall determine risk categories consistently for all hedge accounting disclosures.

25D. To meet the objectives in paragraph 25A, an entity shall (except as otherwise specified below) determine how much detail to disclose, how much emphasis to place on different aspects of the disclosure requirements, the appropriate level of aggregation or disaggregation, and whether users of financial statements need additional explanations to evaluate the quantitative information disclosed. However, an entity shall use the same level of aggregation or disaggregation it uses for disclosure requirements of related information in this Standard.

26. [Deleted]

The Risk Management Strategy

26A. An entity shall explain its risk management strategy for each risk category of risk exposures that it decides to hedge and for which hedge accounting is applied. This explanation should enable users of financial statements to evaluate (for example):

(a) How each risk arises.

(b) How the entity manages each risk; this includes whether the entity hedges an item in its entirety for all risks or hedges a risk component (or components) of an item and why.

(c) The extent of risk exposures that the entity manages.

26B. To meet the requirements in paragraph 26A, the information should include (but is not limited to) a description of:

(a) The hedging instruments that are used (and how they are used) to hedge risk exposures;

(b) How the entity determines the economic relationship between the hedged item and the hedging instrument for the purpose of assessing hedge effectiveness; and

(c) How the entity establishes the hedge ratio and what the sources of hedge ineffectiveness are.

26C. When an entity designates a specific risk component as a hedged item (see paragraph 128 of IPSAS 41) it shall provide, in addition to the disclosures required by paragraphs 26A and 26B, qualitative or quantitative information about:

(a) How the entity determined the risk component that is designated as the hedged item (including a description of the nature of the relationship between the risk component and the item as a whole); and

(b) How the risk component relates to the item in its entirety (for example, the designated risk component historically covered on average 80 percent of the changes in fair value of the item as a whole).

The Amount, Timing and Uncertainty of Future Cash Flows

27. [Deleted]

27A. Unless exempted by paragraph 27C, an entity shall disclose by risk category quantitative information to allow users of its financial statements to evaluate the terms and conditions of hedging instruments and how they affect the amount, timing and uncertainty of future cash flows of the entity.

27B. To meet the requirement in paragraph 27A, an entity shall provide a breakdown that discloses:

(a) A profile of the timing of the nominal amount of the hedging instrument; and

(b) If applicable, the average price or rate (for example strike or forward prices etc.) of the hedging instrument.

27C. In situations in which an entity frequently resets (i.e., discontinues and restarts) hedging relationships because both the hedging instrument and the hedged item frequently change (i.e., the entity uses a dynamic process in which both the exposure and the hedging instruments used to manage that exposure do not remain the same for long—such as in the example in paragraph AG317(b) of IPSAS 41) the entity:

(a) Is exempt from providing the disclosures required by paragraphs 27A and 27B.

(b) Shall disclose:

(i) Information about what the ultimate risk management strategy is in relation to those hedging relationships;

(ii) A description of how it reflects its risk management strategy by using hedge accounting and designating those particular hedging relationships; and

(iii) An indication of how frequently the hedging relationships are discontinued and restarted as part of the entity's process in relation to those hedging relationships.

27D. An entity shall disclose by risk category a description of the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its term.

27E. If other sources of hedge ineffectiveness emerge in a hedging relationship, an entity shall disclose those sources by risk category and explain the resulting hedge ineffectiveness.

27F. For cash flow hedges, an entity shall disclose a description of any forecast transaction for which hedge accounting had been used in the previous period, but which is no longer expected to occur.

The Effects of Hedge Accounting on Financial Position and Performance

28. [Deleted]

28A. An entity shall disclose, in a tabular format, the following amounts related to items designated as hedging instruments separately by risk category for each type of hedge (fair value hedge, cash flow hedge or hedge of a net investment in a foreign operation):

(a) The carrying amount of the hedging instruments (financial assets separately from financial liabilities);

(b) The line item in the statement of financial position that includes the hedging instrument;

(c) The change in fair value of the hedging instrument used as the basis for recognizing hedge ineffectiveness for the period; and

(d) The nominal amounts (including quantities such as tonnes or cubic meters) of the hedging instruments.

28B. An entity shall disclose, in a tabular format, the following amounts related to hedged items separately by risk category for the types of hedges as follows:

(a) For fair value hedges:

(i) The carrying amount of the hedged item recognized in the statement of financial position (presenting assets separately from liabilities);

(ii) The accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item recognized in the statement of financial position (presenting assets separately from liabilities);

(iii) The line item in the statement of financial position that includes the hedged item;

(iv) The change in value of the hedged item used as the basis for recognizing hedge ineffectiveness for the period; and

(v) The accumulated amount of fair value hedge adjustments remaining in the statement of financial position for any hedged items that have ceased to be adjusted for hedging gains and losses in accordance with paragraph 139 of IPSAS 41.

(b) For cash flow hedges and hedges of a net investment in a foreign operation:

(i) The change in value of the hedged item used as the basis for recognizing hedge ineffectiveness for the period (i.e., for cash flow hedges the change in value used to determine the recognized hedge ineffectiveness in accordance with paragraph 140(c) of IPSAS 41);

(ii) The balances in the cash flow hedge reserve and the foreign currency translation reserve for continuing hedges that are accounted for in accordance with paragraphs 140 and 142(a) of IPSAS 41; and

(iii) The balances remaining in the cash flow hedge reserve and the foreign currency translation reserve from any hedging relationships for which hedge accounting is no longer applied.

28C. An entity shall disclose, in a tabular format, the following amounts separately by risk category for the types of hedges as follows:

(a) For fair value hedges:

(i) Hedge ineffectiveness—i.e., the difference between the hedging gains or losses of the hedging instrument and the hedged item—recognized in surplus or deficit (or net assets/equity for hedges of an equity instrument for which an entity has elected to present changes in fair value in net assets/equity in accordance with paragraph 106 of IPSAS 41); and

(ii) The line item in the statement of financial performance that includes the recognized hedge ineffectiveness.

(b) For cash flow hedges and hedges of a net investment in a foreign operation:

(i) Hedging gains or losses of the reporting period that were recognized in net assets/equity;

(ii) Hedge ineffectiveness recognized in surplus or deficit;

(iii) The line item in the statement of financial performance that includes the recognized hedge ineffectiveness;

(iv) The amount reclassified from the cash flow hedge reserve or the foreign currency translation reserve into surplus or deficit as a reclassification adjustment (see IPSAS 1) (differentiating between amounts for which hedge accounting had previously been used, but for which the hedged future cash flows are no longer expected to occur, and amounts that have been transferred because the hedged item has affected surplus or deficit);

(v) The line item in the statement of financial performance that includes the reclassification adjustment (see IPSAS 1); and

(vi) For hedges of net positions, the hedging gains or losses recognized in a separate line item in the statement of financial performance (see paragraph 149 of IPSAS 41).

28D. When the volume of hedging relationships to which the exemption in paragraph 27C applies is unrepresentative of normal volumes during the period (i.e., the volume at the reporting date does not reflect the volumes during the period) an entity shall disclose that fact and the reason it believes the volumes are unrepresentative.

28E. An entity shall provide a reconciliation of each component of net assets/equity and an analysis of net assets/equity in accordance with IPSAS 1 that, taken together:

(a) Differentiates, at a minimum, between the amounts that relate to the disclosures in paragraph 28C(b)(i) and (b)(iv) as well as the amounts accounted for in accordance with paragraph 140(d)(i) and (iii) of IPSAS 41;

(b) Differentiates between the amounts associated with the time value of options that hedge transaction related hedged items and the amounts associated with the time value of options that hedge time-period related hedged items when an entity accounts for the time value of an option in accordance with paragraph 144 of IPSAS 41; and

(c) Differentiates between the amounts associated with forward elements of forward contracts and the foreign currency basis spreads of financial instruments that hedge transaction related hedged items, and the amounts associated with forward elements of forward contracts and the foreign currency basis spreads of financial instruments that hedge time-period related hedged items when an entity accounts for those amounts in accordance with paragraph 145 of IPSAS 41.

28F. An entity shall disclose the information required in paragraph 28E separately by risk category. This disaggregation by risk may be provided in the notes to the financial statements.

Option to Designate a Credit Exposure as Measured at Fair Value Through Surplus or Deficit

28G. If an entity designated a financial instrument, or a proportion of it, as measured at fair value through surplus or deficit because it uses a credit derivative to manage the credit risk of that financial instrument it shall disclose:

(a) For credit derivatives that have been used to manage the credit risk of financial instruments designated as measured at fair value through surplus or deficit in accordance with paragraph 152 of IPSAS 41, a reconciliation of each of the nominal amount and the fair value at the beginning and at the end of the period;

(b) The gain or loss recognized in surplus or deficit on designation of a financial instrument, or a proportion of it, as measured at fair value through surplus or deficit in accordance with paragraph 152 of IPSAS 41; and

(c) On discontinuation of measuring a financial instrument, or a proportion of it, at fair value through surplus or deficit, that financial instrument's fair value that has become the new carrying amount in accordance with paragraph 155 of IPSAS 41 and the related nominal or principal amount (except for providing comparative information in accordance with IPSAS 1, an entity does not need to continue this disclosure in subsequent periods).

Uncertainty Arising from Interest Rate Benchmark Reform

28H. For hedging relationships to which an entity applies the exceptions set out in paragraphs 155D–155L of IPSAS 41 or paragraphs 113D–113N of IPSAS 29, *Financial Instruments: Recognition and Measurement* an entity shall disclose:

(a) The significant interest rate benchmarks to which the entity's hedging relationships are exposed;

(b) The extent of the risk exposure the entity manages that is directly affected by the interest rate benchmark reform;

(c) How the entity is managing the process to transition to alternative benchmark rates;

(d) A description of significant assumptions or judgments the entity made in applying these paragraphs (for example, assumptions or judgments about when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows); and

(e) The nominal amount of the hedging instruments in those hedging relationships.

Additional Disclosures Related to Interest Rate Benchmark Reform—Phase 2

28I. To enable users of financial statements to understand the effect of interest rate benchmark reform on an entity's financial instruments and risk management strategy, an entity shall disclose information about:

(a) The nature and extent of risks to which the entity is exposed arising from financial instruments subject to interest rate benchmark reform, and how the entity manages these risks; and

(b) The entity's progress in completing the transition to alternative benchmark rates, and how the entity is managing the transition.

28J. To meet the objectives in paragraph 28I, an entity shall disclose:

(a) How the entity is managing the transition to alternative benchmark rates, its progress at the reporting date and the risks to which it is exposed arising from financial instruments because of the transition;

(b) Disaggregated by significant interest rate benchmark subject to interest rate benchmark reform, quantitative information about financial instruments that have yet to transition to an alternative benchmark rate as at the end of the reporting period, showing separately:

  (i) Non-derivative financial assets;

  (ii) Non-derivative financial liabilities; and

  (iii) Derivatives; and

(c) If the risks identified in paragraph 28J(a) have resulted in changes to an entity's risk management strategy (see paragraph 26A), a description of these changes.

Fair Value

29. Except as set out in paragraph 35 for each class of financial assets and financial liabilities (see paragraph 9), an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount.

30. In disclosing fair values, an entity shall group financial assets and financial liabilities into classes, but shall offset them only to the extent that their carrying amounts are offset in the statement of financial position.

31. An entity shall disclose for each class of financial instruments the methods and, when a valuation technique is used, the assumptions applied in determining fair values of each class of financial assets or financial liabilities. For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates. If there has been a change in valuation technique, the entity shall disclose that change and the reasons for making it.

32. To make the disclosures required by paragraph 33 an entity shall classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have the following levels:

(a) Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);

(b) Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as price) or indirectly (i.e., derived from prices) (Level 2); and

(c) Inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety shall be determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. For this purpose, the significance of an input is assessed against the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a Level 3 measurement. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.

33. For fair value measurements recognized in the statement of financial position an entity shall disclose for each class of financial instruments:

(a) The level in the fair value hierarchy into which the fair value measurements are categorized in their entirety, segregating fair value measurements in accordance with the levels defined in paragraph 32.

(b) Any significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers. Transfers into each level shall be disclosed and discussed separately from transfers out of each level. For this purpose, significance shall be judged with respect to surplus or deficit, and total assets or total liabilities.

(c) For fair value measurements in Level 3, a reconciliation from the beginning balances to the ending balances, disclosing separately changes during the period attributable to the following:

  (i) Total gains or losses for the period recognized in surplus or deficit, and a description of where they are presented in the statement of financial performance;

  (ii) Total gains or losses recognized in net assets/equity;

  (iii) Purchases, sales, issues, and settlements (each type of movement disclosed separately); and

  (iv) Transfers into or out of Level 3 (e.g., transfers attributable to changes in the observability of market data) and the reasons for those transfers. For significant transfers, transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.

(d) The amount of total gains or losses for the period in (c)(i) above included in surplus or deficit that are attributable to gains or losses relating to those assets and liabilities held at the end of the reporting period and a description of where those gains or losses are presented in the statement of financial performance.

(e) For fair value measurements in Level 3, if changing one or more of the inputs to reasonably possible alternative assumptions would change fair value significantly, the entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to a reasonably possible alternative assumption was calculated. For this purpose, significance shall be judged with respect to surplus or deficit, and total assets or total liabilities, or, when changes in fair value are recognized in net assets/equity, total equity.

An entity shall present the quantitative disclosures required by this paragraph in tabular format unless another format is more appropriate.

34. If the market for a financial instrument is not active, an entity establishes its fair value using a valuation technique (see paragraphs AG149–AG154 of IPSAS 41). Nevertheless, the best evidence of fair value at initial recognition is the transaction price (i.e., the fair value of the consideration given or received), unless conditions described in paragraph AG151 of IPSAS 41 are met. It follows that there could be a difference between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, an entity shall disclose, by class of financial instrument:

(a) Its accounting policy for recognizing that difference in surplus or deficit to reflect a change in factors (including time) that market participants would consider in setting a price (see paragraph AG117(b) of IPSAS 41); and

(b) The aggregate difference yet to be recognized in surplus or deficit at the beginning and end of the period and a reconciliation of changes in the balance of this difference.

35. Disclosures of fair value are not required:

(a) When the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables;

(b) [Deleted]

(c) For a contract containing a discretionary participation feature if the fair value of that feature cannot be measured reliably; or

(d) For lease liabilities.

36. In the case described in paragraph 35(c), an entity shall disclose information to help users of the financial statements make their own judgments about the extent of possible differences between the carrying amount of those contracts and their fair value, including:

(a) The fact that fair value information has not been disclosed for these instruments because their fair value cannot be measured reliably;

(b) A description of the financial instruments, their carrying amount, and an explanation of why fair value cannot be measured reliably;

(c) Information about the market for the instruments;

(d) Information about whether and how the entity intends to dispose of the financial instruments; and

(e) If financial instruments whose fair value previously could not be reliably measured are derecognized, that fact, their carrying amount at the time of derecognition, and the amount of gain or loss recognized.

Concessionary Loans

37. Concessionary loans are granted by entities on below market terms. Examples of concessionary loans that commonly have below market terms include loans to developing countries, small farms, student loans granted to qualifying students for university or college education, and housing loans granted to low income families. For concessionary loans granted and measured at amortized cost in accordance with paragraph 40 of IPSAS 41, an entity shall disclose:

(a) A reconciliation between the opening and closing carrying amounts of the loans, including:

(i) Nominal value of new loans granted during the period;

(ii) The fair value adjustment on initial recognition;

(iii) Loans repaid during the period;

(iv) Impairment losses recognized;

(v) Any increase during the period in the discounted amount arising from the passage of time; and

(vi) Other changes.

(b) Nominal value of the loans at the end of the period;

(c) The purpose and terms of the various types of loans; and

(d) Valuation assumptions.

37A. For concessionary loans measured at fair value in accordance with paragraph 41 or 43 of IPSAS 41 an entity shall disclose:

(a) A reconciliation between the opening and closing carrying amounts of the loans, including:

(i) Nominal value of new loans granted during the period;

(ii) The fair value adjustment on initial recognition;

(iii) Loans repaid during the period;

(iv) The fair value adjustment during the period (separate from initial recognition); and

(v) Other changes.

(b) Nominal value of the loans at the end of the period;

(c) The purpose and terms of the various types of loans, including the nature of the concession; and

(d) Valuation assumptions.

Nature and Extent of Risks Arising from Financial Instruments

38. **An entity shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.**

39. The disclosures required by paragraphs 40–49 focus on the risks that arise from financial instruments and how they have been managed. These risks typically include, but are not limited to, credit risk, liquidity risk, and market risk.

39A. Providing qualitative disclosures in the context of quantitative disclosures enables users to link related disclosures and hence form an overall picture of the nature and extent of risks arising from financial instruments. The interaction between qualitative and quantitative disclosures contributes to disclosure of information in a way that better enables users to evaluate an entity's exposure to risks.

Qualitative Disclosures

40. For each type of risk arising from financial instruments, an entity shall disclose:

(a) The exposures to risk and how they arise;

(b) Its objectives, policies, and processes for managing the risk and the methods used to measure the risk; and

(c) Any changes in (a) or (b) from the previous period.

Quantitative Disclosures

41. For each type of risk arising from financial instruments, an entity shall disclose:

(a) Summary quantitative data about its exposure to that risk at the end of the reporting period. This disclosure shall be based on the information provided internally to key management personnel of the entity (as defined in IPSAS 20, *Related Party Disclosures*), for example, the entity's governing body or chief executive officer.

(b) The disclosures required by paragraphs 43–49, to the extent not provided in accordance with (a).

(c) Concentrations of risk if not apparent from the disclosures made in accordance with (a) and (b).

42. If the quantitative data disclosed as at the end of the reporting period are unrepresentative of an entity's exposure to risk during the period, an entity shall provide further information that is representative.

Credit Risk

Scope and Objectives

42A. An entity shall apply the disclosure requirements in paragraphs 42F–42N to financial instruments to which the impairment requirements in IPSAS 41 are applied. However:

(a) For receivables that result from exchange transactions that are within the scope of IPSAS 9 and non-exchange transactions within the scope of IPSAS 23 and lease receivables, paragraph 42J(a) applies to those receivables or lease receivables on which lifetime expected credit losses are recognized in accordance with paragraph 87 of IPSAS 41, if those financial assets are modified while more than 30 days past due; and

(b) Paragraph 42K(b) does not apply to lease receivables.

42B. The credit risk disclosures made in accordance with paragraphs 42F–42N shall enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows. To achieve this objective, credit risk disclosures shall provide:

(a) Information about an entity's credit risk management practices and how they relate to the recognition and measurement of expected credit losses, including the methods, assumptions and information used to measure expected credit losses;

(b) Quantitative and qualitative information that allows users of financial statements to evaluate the amounts in the financial statements arising from expected credit losses, including changes in the amount of expected credit losses and the reasons for those changes; and

(c) Information about an entity's credit risk exposure (i.e., the credit risk inherent in an entity's financial assets and commitments to extend credit) including significant credit risk concentrations.

42C. An entity need not duplicate information that is already presented elsewhere, provided that the information is incorporated by cross-reference from the financial statements to other statements, such as a management commentary or risk report that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.

42D. To meet the objectives in paragraph 42B, an entity shall (except as otherwise specified) consider how much detail to disclose, how much emphasis to place on different aspects of the disclosure requirements, the appropriate level of aggregation or disaggregation, and whether users of financial statements need additional explanations to evaluate the quantitative information disclosed.

42E. If the disclosures provided in accordance with paragraphs 42F–42N are insufficient to meet the objectives in paragraph 42B, an entity shall disclose additional information that is necessary to meet those objectives.

The Credit Risk Management Practices

42F. An entity shall explain its credit risk management practices and how they relate to the recognition and measurement of expected credit losses. To meet this objective an entity shall disclose information that enables users of financial statements to understand and evaluate:

(a) How an entity determined whether the credit risk of financial instruments has increased significantly since initial recognition, including, if and how:

(i) Financial instruments are considered to have low credit risk in accordance with paragraph 82 of IPSAS 41, including the classes of financial instruments to which it applies; and

(ii) The presumption in paragraph 83 of IPSAS 41, that there have been significant increases in credit risk since initial recognition when financial assets are more than 30 days past due, has been rebutted;

(b) An entity's definitions of default, including the reasons for selecting those definitions;

(c) How the instruments were grouped if expected credit losses were measured on a collective basis;

(d) How an entity determined that financial assets are credit-impaired financial assets;

(e) An entity's write-off policy, including the indicators that there is no reasonable expectation of recovery and information about the policy for financial assets that are written-off but are still subject to enforcement activity; and

(f) How the requirements in paragraph 84 of IPSAS 41 for the modification of contractual cash flows of financial assets have been applied, including how an entity:

(i) Determines whether the credit risk on a financial asset that has been modified while the loss allowance was measured at an amount equal to lifetime expected credit losses, has improved to the extent that the loss allowance reverts to being measured at an amount equal to 12-month expected credit losses in accordance with paragraph 77 of IPSAS 41; and

(ii) Monitors the extent to which the loss allowance on financial assets meeting the criteria in (i) is subsequently remeasured at an amount equal to lifetime expected credit losses in accordance with paragraph 75 of IPSAS 41.

42G. An entity shall explain the inputs, assumptions and estimation techniques used to apply the requirements in paragraphs 73–93 of IPSAS 41. For this purpose an entity shall disclose:

(a) The basis of inputs and assumptions and the estimation techniques used to:

(i) Measure the 12-month and lifetime expected credit losses;

(ii) Determine whether the credit risk of financial instruments has increased significantly since initial recognition; and

(iii) Determine whether a financial asset is a credit-impaired financial asset.

(b) How forward-looking information has been incorporated into the determination of expected credit losses, including the use of macroeconomic information; and

(c) Changes in the estimation techniques or significant assumptions made during the reporting period and the reasons for those changes.

Quantitative and Qualitative Information about Amounts Arising from Expected Credit Losses

42H. To explain the changes in the loss allowance and the reasons for those changes, an entity shall provide, by class of financial instrument, a reconciliation from the opening balance to the closing balance of the loss allowance, in a table, showing separately the changes during the period for:

(a) The loss allowance measured at an amount equal to 12-month expected credit losses;

(b) The loss allowance measured at an amount equal to lifetime expected credit losses for:

(i) Financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets;

(ii) Financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired); and

(iii) Receivables that result from exchange transactions that are within the scope of IPSAS 9 or non-exchange transactions that are within the scope of IPSAS 23 or lease receivables for which the loss allowances are measured in accordance with paragraph 87 of IPSAS 41.

(c) Financial assets that are purchased or originated credit-impaired. In addition to the reconciliation, an entity shall disclose the total amount of undiscounted expected credit losses at initial recognition on financial assets initially recognized during the reporting period.

42I. To enable users of financial statements to understand the changes in the loss allowance disclosed in accordance with paragraph 42H, an entity shall provide an explanation of how significant changes in the gross carrying amount of financial instruments during the period contributed to changes in the loss allowance. The information shall be provided separately for financial instruments that represent the loss allowance as listed in paragraph 42H(a)–(c) and shall include relevant qualitative and quantitative information. Examples of changes in the gross carrying amount of financial instruments that contributed to the changes in the loss allowance may include:

(a) Changes because of financial instruments originated or acquired during the reporting period;

(b) The modification of contractual cash flows on financial assets that do not result in a derecognition of those financial assets in accordance with IPSAS 41;

(c) Changes because of financial instruments that were derecognized (including those that were written-off) during the reporting period; and

(d) Changes arising from whether the loss allowance is measured at an amount equal to 12-month or lifetime expected credit losses.

42J. To enable users of financial statements to understand the nature and effect of modifications of contractual cash flows on financial assets that have not resulted in derecognition and the effect of such modifications on the measurement of expected credit losses, an entity shall disclose:

(a) The amortized cost before the modification and the net modification gain or loss recognized for financial assets for which the contractual cash flows have been modified during the reporting period while they had a loss allowance measured at an amount equal to lifetime expected credit losses; and

(b) The gross carrying amount at the end of the reporting period of financial assets that have been modified since initial recognition at a time when the loss allowance was measured at an amount equal to lifetime expected credit losses and for which the loss allowance has changed during the reporting period to an amount equal to 12-month expected credit losses.

42K. To enable users of financial statements to understand the effect of collateral and other credit enhancements on the amounts arising from expected credit losses, an entity shall disclose by class of financial instrument:

(a) The amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (e.g., netting agreements that do not qualify for offset in accordance with IPSAS 28).

(b) A narrative description of collateral held as security and other credit enhancements, including:

(i) A description of the nature and quality of the collateral held;

(ii) An explanation of any significant changes in the quality of that collateral or credit enhancements as a result of deterioration or changes in the collateral policies of the entity during the reporting period; and

(iii) Information about financial instruments for which an entity has not recognized a loss allowance because of the collateral.

(c) Quantitative information about the collateral held as security and other credit enhancements (for example, quantification of the extent to which collateral and other credit enhancements mitigate credit risk) for financial assets that are credit-impaired at the reporting date.

42L. An entity shall disclose the contractual amount outstanding on financial assets that were written off during the reporting period and are still subject to enforcement activity.

Credit Risk Exposure

42M. To enable users of financial statements to assess an entity’s credit risk exposure and understand its significant credit risk concentrations, an entity shall disclose, by credit risk rating grades, the gross carrying amount of financial assets and the exposure to credit risk on loan commitments and financial guarantee contracts. This information shall be provided separately for financial instruments:

(a) For which the loss allowance is measured at an amount equal to 12-month expected credit losses;

(b) For which the loss allowance is measured at an amount equal to lifetime expected credit losses and that are:

(i) Financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets;

(ii) Financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired); and

(iii) Receivables that result from exchange transactions that are within the scope of IPSAS 9 or non-exchange transactions that are within the scope of IPSAS 23 or lease receivables for which the loss allowances are measured in accordance with paragraph 87 of IPSAS 41.

(c) That are purchased or originated credit-impaired financial assets.

42N. For receivables that result from exchange transactions that are within the scope of IPSAS 9 or non-exchange transactions that are within the scope of IPSAS 23 or lease receivables to which an entity applies paragraph 87 of IPSAS 41, the information provided in accordance with paragraph 42M may be based on a provision matrix (see paragraph AG199 of IPSAS 41).

43. For all financial instruments within the scope of this Standard, but to which the impairment requirements in IPSAS 41 are not applied, an entity shall disclose by class of financial instrument:

(a) The amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (e.g., netting agreements that do not qualify for offset in accordance with IPSAS 28); this disclosure is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk;

(b) A description of collateral held as security and other credit enhancements, and their financial effect (e.g., quantification of the extent to which collateral and other credit enhancements mitigate credit risk) in respect of the amount that best represents the maximum exposure to credit risk (whether disclosed in accordance with (a) or represented by the carrying amount of a financial instrument);

(c) [Deleted]

(d) [Deleted]

44. [Deleted]

Collateral and Other Credit Enhancements Obtained

45. When an entity obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (e.g., guarantees), and such assets meet the recognition criteria in other Standards, an entity shall disclose for such assets held at the reporting date:

(a) The nature and carrying amount of the assets; and

(b) When the assets are not readily convertible into cash, its policies for disposing of such assets or for using them in its operations.

Liquidity Risk

46. An entity shall disclose:

(a) A maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.

(b) A maturity analysis for derivative financial liabilities. The maturity analysis shall include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows (see paragraph AG14).

(c) A description of how it manages the liquidity risk inherent in (a) and (b).

Market Risk

Sensitivity Analysis

47. Unless an entity complies with paragraph 48, it shall disclose:

(a) A sensitivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how surplus or deficit and net assets/equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;

(b) The methods and assumptions used in preparing the sensitivity analysis; and

(c) Changes from the previous period in the methods and assumptions used, and the reasons for such changes.

48. If an entity prepares a sensitivity analysis, such as value-at-risk, that reflects interdependencies between risk variables (e.g., interest rates and exchange rates) and uses it to manage financial risks, it may use that sensitivity analysis in place of the analysis specified in paragraph 47. The entity shall also disclose:

(a) An explanation of the method used in preparing such a sensitivity analysis, and of the main parameters and assumptions underlying the data provided; and

(b) An explanation of the objective of the method used and of limitations that may result in the information not fully reflecting the fair value of the assets and liabilities involved.

Other Market Risk Disclosures

49. When the sensitivity analyses disclosed in accordance with paragraph 47 or 48 are unrepresentative of a risk inherent in a financial instrument (e.g., because the year-end exposure does not reflect the exposure during the year), the entity shall disclose that fact and the reason it believes the sensitivity analyses are unrepresentative.

Transfers of Financial Assets

49A. The disclosure requirements in paragraphs 49B–49H relating to transfers of financial assets supplement the other disclosure requirements of this Standard. An entity shall present the disclosures required by paragraphs 49B–49H in a single note in its financial statements. An entity shall provide the required disclosures for all transferred financial assets that are not derecognized and for any continuing involvement in a transferred asset, existing at the reporting date, irrespective of when the related transfer transaction occurred. For the purposes of applying the disclosure requirements in those paragraphs, an entity transfers all or a part of a financial asset (the transferred financial asset) if, and only if, it either:

(a) Transfers the contractual rights to receive the cash flows of that financial asset; or

(b) Retains the contractual rights to receive the cash flows of that financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement.

49B. An entity shall disclose information that enables users of its financial statements:

(a) To understand the relationship between transferred financial assets that are not derecognized in their entirety and the associated liabilities; and

(b) To evaluate the nature of, and risks associated with, the entity's continuing involvement in derecognized financial assets.

49C. For the purposes of applying the disclosure requirements in paragraphs 49E–49H, an entity has continuing involvement in a transferred financial asset if, as part of the transfer, the entity retains any of the contractual rights or obligations inherent in the transferred financial asset or obtains any new contractual rights or obligations relating to the transferred financial asset. For the purposes of applying the disclosure requirements in paragraphs 49E–49H, the following do not constitute continuing involvement:

(a) Normal representations and warranties relating to fraudulent transfer and concepts of reasonableness, good faith and fair dealings that could invalidate a transfer as a result of legal action;

(b) Forward, option and other contracts to reacquire the transferred financial asset for which the contract price (or exercise price) is the fair value of the transferred financial asset; or

(c) An arrangement whereby an entity retains the contractual rights to receive the cash flows of a financial asset but assumes a contractual obligation to pay the cash flows to one or more entities and the conditions in paragraph 16(a)–(c) of IPSAS 41 are met.

Transferred Financial Assets that are Not Derecognized in Their Entirety

49D. An entity may have transferred financial assets in such a way that part or all of the transferred financial assets do not qualify for derecognition. To meet the objectives set out in paragraph 49B(a), the entity shall disclose at each reporting date for each class of transferred financial assets that are not derecognized in their entirety:

(a) The nature of the transferred assets.

(b) The nature of the risks and rewards of ownership to which the entity is exposed.

(c) A description of the nature of the relationship between the transferred assets and the associated liabilities, including restrictions arising from the transfer on the reporting entity's use of the transferred assets.

(d) When the counterparty (counterparties) to the associated liabilities has (have) recourse only to the transferred assets, a schedule that sets out the fair value of the transferred assets, the fair value of the associated liabilities and the net position (the difference between the fair value of the transferred assets and the associated liabilities).

(e) When the entity continues to recognize all of the transferred assets, the carrying amounts of the transferred assets and the associated liabilities.

(f) When the entity continues to recognize the assets to the extent of its continuing involvement (see paragraphs 17(c)(ii) and 27 of IPSAS 41), the total carrying amount of the original assets before the transfer, the carrying amount of the assets that the entity continues to recognize, and the carrying amount of the associated liabilities.

Transferred Financial Assets that are Derecognized in Their Entirety

49E. To meet the objectives set out in paragraph 49B(b), when an entity derecognizes transferred financial assets in their entirety (see paragraph 17(a) and 17(c)(i) of IPSAS 41) but has continuing involvement in them, the entity shall disclose, as a minimum, for each type of continuing involvement at each reporting date:

(a) The carrying amount of the assets and liabilities that are recognized in the entity's statement of financial position and represent the entity's continuing involvement in the derecognized financial assets, and the line items in which the carrying amount of those assets and liabilities are recognized.

(b) The fair value of the assets and liabilities that represent the entity's continuing involvement in the derecognized financial assets.

(c) The amount that best represents the entity's maximum exposure to loss from its continuing involvement in the derecognized financial assets, and information showing how the maximum exposure to loss is determined.

(d) The undiscounted cash outflows that would or may be required to repurchase derecognized financial assets (e.g., the strike price in an option agreement) or other amounts payable to the transferee in respect of the transferred assets. If the cash outflow is variable then the amount disclosed should be based on the conditions that exist at each reporting date.

(e) A maturity analysis of the undiscounted cash outflows that would or may be required to repurchase the derecognized financial assets or other amounts payable to the transferee in respect of the transferred assets, showing the remaining contractual maturities of the entity's continuing involvement.

(f) Qualitative information that explains and supports the quantitative disclosures required in (a)–(e).

49F. An entity may aggregate the information required by paragraph 49E in respect of a particular asset if the entity has more than one type of continuing involvement in that derecognized financial asset, and report it under one type of continuing involvement.

49G. In addition, an entity shall disclose for each type of continuing involvement:

(a) The gain or loss recognized at the date of transfer of the assets.

(b) Revenue and expenses recognized, both in the reporting period and cumulatively, from the entity's continuing involvement in the derecognized financial assets (e.g., fair value changes in derivative instruments).

(c) If the total amount of proceeds from transfer activity (that qualifies for derecognition) in a reporting period is not evenly distributed throughout the reporting period (e.g., if a substantial proportion of the total amount of transfer activity takes place in the closing days of a reporting period):

(i) When the greatest transfer activity took place within that reporting period (e.g., the last five days before the end of the reporting period),

(ii) The amount (e.g., related gains or losses) recognized from transfer activity in that part of the reporting period, and

(iii) The total amount of proceeds from transfer activity in that part of the reporting period.

An entity shall provide this information for each period for which a statement of net assets/equity is presented.

Supplementary Information

49H. An entity shall disclose any additional information that it considers necessary to meet the disclosure objectives in paragraph 49B.

Initial Application of IPSAS 41

49I. In the reporting period that includes the date of initial application of IPSAS 41, the entity shall disclose the following information for each class of financial assets and financial liabilities as at the date of initial application:

(a) The original measurement category and carrying amount determined in accordance with IPSAS 29;

(b) The new measurement category and carrying amount determined in accordance with IPSAS 41;

(c) The amount of any financial assets and financial liabilities in the statement of financial position that were previously designated as measured at fair value through surplus or deficit but are no longer so designated, distinguishing between those that IPSAS 41 requires an entity to reclassify and those that an entity elects to reclassify at the date of initial application.

49J. In the reporting period that includes the date of initial application of IPSAS 41, an entity shall disclose qualitative information to enable users to understand:

(a) How it applied the classification requirements in IPSAS 41 to those financial assets whose classification has changed as a result of applying IPSAS 41.

(b) The reasons for any designation or de-designation of financial assets or financial liabilities as measured at fair value through surplus or deficit at the date of initial application.

49K. In the reporting period that an entity first applies the classification and measurement requirements for financial assets in IPSAS 41 (i.e., when the entity transitions from IPSAS 29 to IPSAS 41 for financial assets), it shall present the disclosures set out in paragraphs 49L–49O of this Standard as required by paragraph 173 of IPSAS 41.

49L. When required by paragraph 49K, an entity shall disclose the changes in the classifications of financial assets and financial liabilities as at the date of initial application of IPSAS 41, showing separately:

(a) The changes in the carrying amounts on the basis of their measurement categories in accordance with IPSAS 29 (i.e., not resulting from a change in measurement attribute on transition to IPSAS 41); and

(b) The changes in the carrying amounts arising from a change in measurement attribute on transition to IPSAS 41.

The disclosures in this paragraph need not be made after the reporting period in which the entity initially applies the classification and measurement requirements for financial assets in IPSAS 41.

49M. When required by paragraph 49K, an entity shall disclose the following for financial assets and financial liabilities that have been reclassified so that they are measured at amortized cost and, in the case of financial assets, that have been reclassified out of fair value through surplus or deficit so that they are measured at fair value through net assets/equity, as a result of the transition to IPSAS 41:

(a) The fair value of the financial assets or financial liabilities at the end of the reporting period; and

(b) The fair value gain or loss that would have been recognized in surplus or deficit or net assets/equity during the reporting period if the financial assets or financial liabilities had not been reclassified.

The disclosures in this paragraph need not be made after the reporting period in which the entity initially applies the classification and measurement requirements for financial assets in IPSAS 41.

49N. When required by paragraph 49K, an entity shall disclose the following for financial assets and financial liabilities that have been reclassified out of the fair value through surplus or deficit category as a result of the transition to IPSAS 41:

(a) The effective interest rate determined on the date of initial application; and

(b) The interest revenue or expense recognized.

If an entity treats the fair value of a financial asset or a financial liability as the new gross carrying amount at the date of initial application (see paragraph 168 of IPSAS 41), the disclosures in this paragraph shall be made for each reporting period until derecognition. Otherwise, the disclosures in this paragraph need not be made after the reporting period in which the entity initially applies the classification and measurement requirements for financial assets in IPSAS 41.

49O. When an entity presents the disclosures set out in paragraphs 49K–49N, those disclosures, and the disclosures in paragraph 29 of this Standard, must permit reconciliation between:

(a) The measurement categories presented in accordance with IPSAS 29 and IPSAS 41; and

(b) The class of financial instrument

as at the date of initial application.

49P. On the date of initial application of paragraphs 73–93 of IPSAS 41, an entity is required to disclose information that would permit the reconciliation of the ending impairment allowances in accordance with IPSAS 29 and the provisions in accordance with IPSAS 19 to the opening loss allowances determined in accordance with IPSAS 41. For financial assets, this disclosure shall be provided by the related financial assets' measurement categories in accordance with IPSAS 29 and IPSAS 41, and shall show separately the effect of the changes in the measurement category on the loss allowance at that date.

49Q. In the reporting period that includes the date of initial application of IPSAS 41, an entity is not required to disclose the line item amounts that would have been reported in accordance with the classification and measurement requirements (which includes the requirements related to amortized cost measurement of financial assets and impairment in paragraphs 69–72 and 73–93 of IPSAS 41) of:

(a) IPSAS 41 for prior periods; and

(b) IPSAS 29 for the current period.

49R. In accordance with paragraph 161 of IPSAS 41, if it is impracticable (as defined in IPSAS 3) at the date of initial application of IPSAS 41 for an entity to assess a modified time value of money element in accordance with paragraphs AG68–AG70 of IPSAS 41 based on the facts and circumstances that existed at the initial recognition of the financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset based on the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the requirements related to the modification of the time value of money element in paragraphs AG68–AG70 of IPSAS 41. An entity shall disclose the carrying amount at the reporting date of the financial assets whose contractual cash flow characteristics have been assessed based on the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the requirements related to the modification of the time value of money element in paragraphs AG68–AG70 of IPSAS 41 until those financial assets are derecognized.

49S. In accordance with paragraph 162 of IPSAS 41, if it is impracticable (as defined in IPSAS 3) at the date of initial application for an entity to assess whether the fair value of a prepayment feature was insignificant in accordance with paragraphs AG74(c) of IPSAS 41 based on the facts and circumstances that existed at the initial recognition of the financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset based on the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the exception for prepayment features in paragraph AG74 of IPSAS 41. An entity shall disclose the carrying amount at the reporting date of the financial assets whose contractual cash flow characteristics have been assessed based on the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the exception for prepayment features in paragraph AG74 of IPSAS 41 until those financial assets are derecognized.

Effective Date and Transition

50. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2013. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2013, it shall disclose that fact.**

51. **An entity shall not apply this Standard before January 1, 2013, unless it also applies IPSAS 28 and IPSAS 29.**

52. If an entity applies this Standard for annual periods beginning before January 1, 2013, it need not present comparative information for the disclosures required by paragraphs 38–49 about the nature and extent of risks arising from financial instruments.

52A. **Paragraph 53 was amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendment shall also be applied for that earlier period.**

52B. **IPSAS 35, *Consolidated Financial Statements*, IPSAS 37, *Joint Arrangements*, and IPSAS 38, *Disclosures of Interests in Other Entities,* issued in January 2015, amended paragraphs 3(a) and AG6. An entity shall apply that amendment when it applies IPSAS 35, IPSAS 37 and IPSAS 38.**

52C. **Paragraph AG7 was amended by *Improvements to IPSASs 2015* issued in April 2016. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2017 it shall disclose that fact.**

52D. **Paragraphs 6 and 7 were deleted by *The Applicability of IPSASs*, issued in April 2016. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2018. Earlier**

application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2018, it shall disclose that fact.

52E. **Paragraph 3 was amended by IPSAS 39, *Employee Benefits*, issued in July 2016. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2018 it shall disclose that fact and apply IPSAS 39 at the same time.**

52F. **Paragraphs 2, 3, 4, 5, 8, 11, 12, 13, 14, 18, 24, 34, 35, 36, 37, 41, 43, 45, AG1, AG5, AG9, AG10, AG24, and AG29 were amended, paragraphs 16, 17, 20, 26, 27, 28 and 44 were deleted and several headings and paragraphs 5A, 13A, 14A, 14B, 15A, 15B, 15C, 17A, 17B, 17C, 17D, 17E, 17F, 20A, 24A, 25A, 25B, 25C, 25D, 26A, 26B, 26C, 27A, 27B, 27C, 27D, 27E, 27F, 28A, 28B, 28C, 28D, 28E, 28F, 28G, 37A, 39A, 42A, 42B, 42C, 42D, 42E, 42F, 42G, 42H, 42I, 42J, 42K, 42L, 42M, 42N, 49A, 49B, 49C, 49D, 49E, 49F, 49G, 49H, 49I, 49J, 49K, 49L, 49M, 49N, 49O, 49P, 49Q, 49R, 49S, 52C, 52D, AG8A, AG8B, AG8C, AG8D, AG8E, AG8F, AG8G, AG8H, AG8I, AG8J, AG31, AG32, AG32A, AG33, AG34, AG35, AG36, AG37, AG38, AG39, AG40, AG41, AG42, AG43, AG44, AG45, AG46, AG47, AG48, AG49, AG50, AG51, AG52, AG53, AG54 and AG55 are added by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply IPSAS 41 at the same time.**

52G. **Paragraph AG5 was amended by *Improvements to IPSAS, 2019*, issued in January 2020. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is permitted. If an entity applies this amendment for a period beginning before January 1, 2023, it shall disclose that fact and apply IPSAS 41 at the same time.**

52H. **Paragraphs 28H and 52I were added by *Improvements to IPSAS, 2021*, issued in January 2022. An entity shall apply these amendments when it applies the *Interest Rate Benchmark Reform* amendments to IPSAS 29 or IPSAS 41.**

52I. In the reporting period in which an entity first applies *Interest Rate Benchmark Reform amendments*, an entity is not required to present the quantitative information required by paragraph 33(f) of IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.

52J. **Paragraphs 28I–28J and 52K were added by *Improvements to IPSAS, 2021*, issued in January 2022. An entity shall apply these amendments when it applies the *Interest Rate Benchmark Reform—Phase 2* amendments to IPSAS 29 or IPSAS 41.**

52K. In the reporting period in which an entity first applies *Interest Rate Benchmark Reform—Phase 2* amendments an entity is not required to present the quantitative information required by paragraph 33(f) of IPSAS 3.

52L. **Paragraphs 35 and AG16 were amended by IPSAS 43, *Leases* issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.**

53. When an entity adopts the accrual basis IPSASs of accounting as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

Withdrawal and Replacement of IPSAS 15 (2001)

54. This Standard and IPSAS 28 supersede IPSAS 15, *Financial Instruments: Disclosure and Presentation* issued in 2001. IPSAS 15 remains applicable until IPSAS 28 and IPSAS 30 are applied or become effective, whichever is earlier.

Appendix A

Application Guidance

This appendix is an integral part of IPSAS 30.

Classes of Financial Instruments and Level of Disclosure (paragraph 9)

AG1. Paragraph 9 requires an entity to group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. The classes described in paragraph 9 are determined by the entity and are, thus, distinct from the categories of financial instruments specified in IPSAS 41 (which determine how financial instruments are measured and where changes in fair value are recognized).

AG2. In determining classes of financial instrument, an entity shall, at a minimum:

(a) Distinguish instruments measured at amortized cost from those measured at fair value.

(b) Treat as a separate class or classes those financial instruments outside the scope of this Standard.

AG3. An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this Standard, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation. For example, an entity shall not obscure important information by including it among a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between individual transactions or associated risks.

AG4. [Deleted]

Other Disclosure—Accounting Policies (paragraph 25)

AG5. Paragraph 25 requires disclosure of the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements. For financial instruments, such disclosure may include:

(a) For financial liabilities designated as at fair value through surplus or deficit:

(i) The nature of the financial liabilities the entity has designated as at fair value through surplus or deficit;

(ii) The criteria for so designating such financial liabilities on initial recognition; and

(iii) How the entity has satisfied the conditions in paragraph 46, of IPSAS 41 for such designation.

(b) For financial assets designated as measured at fair value through surplus or deficit:

(i) The nature of the financial assets the entity has designated as measured at fair value through surplus or deficit; and

(ii) How the entity has satisfied the criteria in paragraph 44 of IPSAS 41 for such designation.

(c) Whether regular way purchases and sales of financial assets are accounted for at trade date or at settlement date (see paragraph 11 of IPSAS 41).

(d) [Deleted]

(e) How net gains or net losses on each category of financial instrument are determined (see paragraph 24(a)), for example, whether the net gains or net losses on items at fair value through surplus or deficit include interest or revenue from dividends or similar distributions.

(f) [Deleted]

(g) [Deleted]

(h) For financial guarantee contracts issued through a non-exchange transaction, where no fair value can be determined and on initial recognition the financial guarantee contract is measured at the amount of the loss allowance in accordance with paragraph AG136 of IPSAS 41, disclosure of the circumstances that result in fair value not being determinable.

Paragraph 137 of IPSAS 1 also requires entities to disclose, in the summary of significant accounting policies or other notes, the judgments, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognized in the financial statements.

Nature and Extent of Risks Arising from Financial Instruments (paragraphs 38–49)

AG6. The disclosures required by paragraphs 38–49 shall be either given in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete. The use of such cross-referencing may be subject to jurisdictional restrictions.

Quantitative Disclosures (paragraph 41)

AG7. Paragraph 41(a) requires disclosures of summary quantitative data about an entity's exposure to risks based on the information provided internally to key management personnel of the entity. When an entity uses several methods to manage a risk exposure, the entity shall disclose information using the method or methods that provide the most relevant and faithfully representative information. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* discusses relevance and faithful representation.

AG8. Paragraph 41(c) requires disclosures about concentrations of risk. Concentrations of risk arise from financial instruments that have similar characteristics and are affected similarly by changes in economic or other conditions. The identification of concentrations of risk requires judgment taking into account the circumstances of the entity. Disclosure of concentrations of risk shall include:

(a) A description of how management determines concentrations;

(b) A description of the shared characteristic that identifies each concentration (e.g., counterparty, geographical area, currency, or market); and

(c) The amount of the risk exposure associated with all financial instruments sharing that characteristic.

Credit Risk Management Practices (paragraphs 42F–42G)

AG8A. Paragraph 42F(b) requires the disclosure of information about how an entity has defined default for different financial instruments and the reasons for selecting those definitions. In accordance with paragraph 81 of IPSAS 41, the determination of whether lifetime expected credit losses should be recognized is based on the increase in the risk of a default occurring since initial recognition. Information about an entity's definitions of default that will assist users of financial statements in understanding how an entity has applied the expected credit loss requirements in IPSAS 41 may include:

(a) The qualitative and quantitative factors considered in defining default;

(b) Whether different definitions have been applied to different types of financial instruments; and

(c) Assumptions about the cure rate (i.e., the number of financial assets that return to a performing status) after a default occurred on the financial asset.

AG8B. To assist users of financial statements in evaluating an entity's restructuring and modification policies, paragraph 42F(f)(i) requires the disclosure of information about how an entity monitors the extent to which the loss allowance on financial assets previously disclosed in accordance with paragraph 42F(f)(i) are subsequently measured at an amount equal to lifetime expected credit losses in accordance with paragraph 75 of IPSAS 41. Quantitative information that will assist users in understanding the subsequent increase in credit risk of modified financial assets may include information about modified financial assets meeting the criteria in paragraph 42F(f)(i) for which the loss allowance has reverted to being measured at an amount equal to lifetime expected credit losses (i.e., a deterioration rate).

AG8C. Paragraph 42G(a) requires the disclosure of information about the basis of inputs and assumptions and the estimation techniques used to apply the impairment requirements in IPSAS 41. An entity's assumptions and inputs used to measure expected credit losses or determine the extent of increases in credit risk since initial recognition may include information obtained from internal historical information or rating reports and assumptions about the expected life of financial instruments and the timing of the sale of collateral.

Changes in the Loss Allowance (paragraph 42H)

AG8D. In accordance with paragraph 42H, an entity is required to explain the reasons for the changes in the loss allowance during the period. In addition to the reconciliation from the opening balance to the closing balance of the loss allowance, it may be necessary to provide a narrative explanation of the changes. This narrative explanation may include an analysis of the reasons for changes in the loss allowance during the period, including:

(a) The portfolio composition;

(b) The volume of financial instruments purchased or originated; and

(c) The severity of the expected credit losses

AG8E. For loan commitments and financial guarantee contracts the loss allowance is recognized as a provision. An entity should disclose information about the changes in the loss allowance for financial assets separately from those for loan commitments and financial guarantee contracts. However, if a financial instrument includes both a loan (i.e., financial asset) and an undrawn commitment (i.e., loan commitment) component and the entity cannot separately identify the expected credit losses on the loan commitment component from those on the financial asset component, the expected credit losses on the loan commitment should be recognized together with the loss allowance for the financial asset. To the extent that the combined expected credit losses exceed the gross carrying amount of the financial asset, the expected credit losses should be recognized as a provision.

Collateral (paragraph 42K)

AG8F. Paragraph 42K requires the disclosure of information that will enable users of financial statements to understand the effect of collateral and other credit enhancements on the amount of expected credit losses. An entity is neither required to disclose information about the fair value of collateral and other credit enhancements nor is it required to quantify the exact value of the collateral that was included in the calculation of expected credit losses (i.e., the loss given default).

AG8G. A narrative description of collateral and its effect on amounts of expected credit losses might include information about:

(a) The main types of collateral held as security and other credit enhancements (examples of the latter being guarantees, credit derivatives and netting agreements that do not qualify for offset in accordance with IPSAS 28);

(b) The volume of collateral held and other credit enhancements and its significance in terms of the loss allowance;

(c) The policies and processes for valuing and managing collateral and other credit enhancements;

(d) The main types of counterparties to collateral and other credit enhancements and their creditworthiness; and

(e) Information about risk concentrations within the collateral and other credit enhancements.

Credit Risk Exposure (paragraphs 42M–42N)

AG8H. Paragraph 42M requires the disclosure of information about an entity's credit risk exposure and significant concentrations of credit risk at the reporting date. A concentration of credit risk exists when a number of counterparties are located in a geographical region or are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. An entity should provide information that enables users of financial statements to understand whether there are groups or portfolios of financial instruments with particular features that could affect a large portion of that group of financial instruments such as concentration to particular risks. This could include, for example, loan-to-value groupings, geographical, industry or issuer-type concentrations.

AG8I. The number of credit risk rating grades used to disclose the information in accordance with paragraph 42M shall be consistent with the number that the entity reports to key management personnel for credit risk management purposes. If past due information is the only borrower-specific information available and an entity uses past due information to assess whether credit risk has increased significantly since initial recognition in accordance with paragraph 82 of IPSAS 41, an entity shall provide an analysis by past due status for those financial assets.

AG8J. When an entity has measured expected credit losses on a collective basis, the entity may not be able to allocate the gross carrying amount of individual financial assets or the exposure to credit risk on loan commitments and financial guarantee contracts to the credit risk rating grades for which lifetime expected credit losses are recognized. In that case, an entity should apply the requirement in paragraph 42M to those financial instruments that can be directly allocated to a credit risk rating grade and disclose separately the gross carrying amount of financial instruments for which lifetime expected credit losses have been measured on a collective basis.

Maximum Credit Risk Exposure (paragraph 43(a))

AG9. Paragraphs 42K(a) and 43(a) requires disclosure of the amount that best represents the entity's maximum exposure to credit risk. For a financial asset, this is typically the gross carrying amount, net of:

(a) Any amounts offset in accordance with IPSAS 28; and

(b) Any loss allowance recognized in accordance with IPSAS 41.

AG10. Activities that give rise to credit risk and the associated maximum exposure to credit risk include, but are not limited to:

(a) Granting loans to customers and placing deposits with other entities. In these cases, the maximum exposure to credit risk is the carrying amount of the related financial assets.

(b) Entering into derivative contracts (e.g., foreign exchange contracts, interest rate swaps, and credit derivatives). When the resulting asset is measured at fair value, the maximum exposure to credit risk at the end of the reporting period will equal the carrying amount.

(c) Granting financial guarantees. In this case, the maximum exposure to credit risk is the maximum amount the entity could have to pay if the guarantee is called on, which may be significantly greater than the amount recognized as a liability.

(d) Making a loan commitment that is irrevocable over the life of the facility or is revocable only in response to a material adverse change. If the issuer cannot settle the loan commitment net in cash or another financial instrument, the maximum credit exposure is the full amount of the commitment. This is because it is uncertain whether the amount of any undrawn portion may be drawn upon in the future. This may be significantly greater than the amount recognized as a liability.

Quantitative Liquidity Risk Disclosures (paragraphs 41(a), and 46(a) and (b))

AG11. In accordance with paragraph 41(a) an entity discloses summary quantitative data about its exposure to liquidity risk on the basis of the information provided internally to key management personnel. An entity shall explain how those data are determined. If the outflows of cash (or another financial asset) included in those data could either:

(a) Occur significantly earlier than indicated in the data; or

(b) Be for significantly different amounts from those indicated in the data (e.g., for a derivative that is included in the data on a net settlement basis but for which the counterparty has the option to require gross settlement);

the entity shall state that fact and provide quantitative information that enables users of its financial statements to evaluate the extent of this risk unless that information is included in the contractual maturity analyses required by paragraph 46(a) or (b).

AG12. In preparing the maturity analyses required by paragraph 46(a) and (b), an entity uses its judgment to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:

(a) Not later than one month;

(b) Later than one month and not later than three months;

(c) Later than three months and not later than one year; and

(d) Later than one year and not later than five years.

AG13. In complying with paragraph 46(a) and (b), an entity shall not separate an embedded derivative from a hybrid (combined) instrument. For such an instrument, an entity shall apply paragraph 46(a).

AG14. Paragraph 46(b) requires an entity to disclose a quantitative maturity analysis for derivative financial liabilities that shows remaining contractual maturities if the contractual maturities are essential for an understanding of the timing of the cash flows. For example, this would be the case for:

(a) An interest rate swap with a remaining maturity of five years in a cash flow hedge of a variable rate financial asset or liability.

(b) All loan commitments.

AG15. Paragraph 46(a) and (b) requires an entity to disclose maturity analyses for financial liabilities that show the remaining contractual maturities for some financial liabilities. In this disclosure:

(a) When a counterparty has a choice of when an amount is paid, the liability is allocated to the earliest period in which the entity can be required to pay. For example, financial liabilities that an entity can be required to repay on demand (e.g., demand deposits) are included in the earliest time band.

(b) When an entity is committed to make amounts available in instalments, each instalment is allocated to the earliest period in which the entity can be required to pay. For example, an undrawn loan commitment is included in the time band containing the earliest date it can be drawn down.

(c) For issued financial guarantee contracts the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

AG16. The contractual amounts disclosed in the maturity analyses as required by paragraph 46(a) and (b) are the contractual undiscounted cash flows, for example:

(a) Gross lease liabilities (before deducting finance charges);

(b) Prices specified in forward agreements to purchase financial assets for cash;

(c) Net amounts for pay-floating/receive-fixed interest rate swaps for which net cash flows are exchanged;

(d) Contractual amounts to be exchanged in a derivative financial instrument (e.g., a currency swap) for which gross cash flows are exchanged; and

(e) Gross loan commitments.

Such undiscounted cash flows differ from the amount included in the statement of financial position because the amount in that statement is based on discounted cash flows. When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. For example, when the amount payable varies with changes in an index, the amount disclosed may be based on the level of the index at the end of the period.

AG17. Paragraph 46(c) requires an entity to describe how it manages the liquidity risk inherent in the items disclosed in the quantitative disclosures required in paragraph 40(a) and (b). An entity shall disclose a maturity analysis of financial assets it holds for managing liquidity risk (e.g., financial assets that are readily saleable or expected to generate cash inflows to meet cash outflows on financial liabilities), if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk.

AG18. Other factors that an entity might consider in providing the disclosure required in paragraph 46(c) include, but are not limited to, whether the entity:

(a) Has committed borrowing facilities (e.g., commercial paper facilities) or other lines of credit (e.g., stand-by credit facilities) that it can access to meet liquidity needs;

(b) Holds deposits at central banks to meet liquidity needs;

(c) Has very diverse funding sources;

(d) Has significant concentrations of liquidity risk in either its assets or its funding sources;

(e) Has internal control processes and contingency plans for managing liquidity risk;

(f) Has instruments that include accelerated repayment terms (e.g., on the downgrade of the entity's credit rating);

(g) Has instruments that could require the posting of collateral (e.g., margin calls for derivatives);

(h) Has instruments that allows the entity to choose whether it settles its financial liabilities by delivering cash (or another financial asset) or by delivering its own shares; or

(i) Has instruments that are subject to master netting agreements.

Market Risk—Sensitivity Analysis (paragraphs 47 and 48)

AG19. Paragraph 47(a) requires a sensitivity analysis for each type of market risk to which the entity is exposed. In accordance with paragraph AG3, an entity decides how it aggregates information to display the overall picture without combining information with different characteristics about exposures to risks from significantly different economic environments. For example:

(a) An entity that trades financial instruments might disclose this information separately for financial instruments held for trading and those not held for trading.

(b) An entity would not aggregate its exposure to market risks from areas of hyperinflation with its exposure to the same market risks from areas of very low inflation.

If an entity has exposure to only one type of market risk in only one economic environment, it would not show disaggregated information.

AG20. Paragraph 47(a) requires the sensitivity analysis to show the effect on surplus or deficit and net assets/equity of reasonably possible changes in the relevant risk variable (e.g., prevailing market interest rates, currency rates, equity prices, or commodity prices). For this purpose:

(a) Entities are not required to determine what the surplus or deficit for the period would have been if relevant risk variables had been different. Instead, entities disclose the effect on surplus or deficit and net assets/equity at the end of the reporting period assuming that a reasonably possible change in the relevant risk variable had occurred at the end of the reporting period and had been applied to the risk exposures in existence at that date. For example, if an entity has a floating rate liability at the end of the year, the entity would disclose the effect on surplus or deficit (i.e., interest expense) for the current year if interest rates had varied by reasonably possible amounts.

(b) Entities are not required to disclose the effect on surplus or deficit and net assets/equity for each change within a range of reasonably possible changes of the relevant risk variable. Disclosure of the effects of the changes at the limits of the reasonably possible range would be sufficient.

AG21. In determining what a reasonably possible change in the relevant risk variable is, an entity should consider:

(a) The economic environments in which it operates. A reasonably possible change should not include remote or "worst case" scenarios or "stress tests". Moreover, if the rate of change in the underlying risk variable is stable, the entity need not alter the chosen reasonably possible change in the risk variable. For example, assume that interest rates are 5 percent and an entity determines that a fluctuation in interest rates of ±50 basis points is reasonably possible. It would disclose the effect on surplus or deficit and net assets/equity if interest rates were to change to 4.5 percent or 5.5 percent. In the next period, interest rates have increased to 5.5 percent. The entity continues to believe that interest rates may fluctuate by ±50 basis points (i.e., that the rate of change in interest rates is stable). The entity would disclose the effect on surplus or deficit and net assets/equity if interest rates were to change to 5 percent or 6 percent. The entity would not be required to revise its assessment that interest rates might reasonably fluctuate by ±50 basis points, unless there is evidence that interest rates have become significantly more volatile.

(b) The time frame over which it is making the assessment. The sensitivity analysis shall show the effects of changes that are considered to be reasonably possible over the period until the entity will next present these disclosures, which is usually its next annual reporting period.

AG22. Paragraph 48 permits an entity to use a sensitivity analysis that reflects interdependencies between risk variables, such as a value-at-risk methodology, if it uses this analysis to manage its exposure to financial risks. This applies even if such a methodology measures only the potential for loss and does not measure the potential for gain. Such an entity might comply with paragraph 48(a) by disclosing the type of value-at-risk model used (e.g., whether the model relies on Monte Carlo simulations), an explanation about how the model works and the main assumptions (e.g., the holding period and confidence level). Entities might also disclose the historical observation period and weightings applied to observations within that period, an explanation of how options are dealt with in the calculations, and which volatilities and correlations (or, alternatively, Monte Carlo probability distribution simulations) are used.

AG23. An entity shall provide sensitivity analyses for the whole of its operations, but may provide different types of sensitivity analysis for different classes of financial instruments.

Interest Rate Risk

AG24. Interest rate risk arises on interest-bearing financial instruments recognized in the statement of financial position (e.g., debt instruments acquired or issued) and on some financial instruments not recognized in the statement of financial position (e.g., some loan commitments).

Currency Risk

AG25. Currency risk (or foreign exchange risk) arises on financial instruments that are denominated in a foreign currency (i.e., in a currency other than the functional currency in which they are measured). For the purpose of this Standard, currency risk does not arise from financial instruments that are non-monetary items or from financial instruments denominated in the functional currency.

AG26. A sensitivity analysis is disclosed for each currency to which an entity has significant exposure.

Other Price Risk

AG27. Other price risk arises on financial instruments because of changes in, for example, commodity prices or equity prices. To comply with paragraph 47, an entity might disclose the effect of a decrease in a specified stock market index, commodity price, or other risk variable. For example, if an entity gives residual value guarantees that are financial instruments, the entity discloses an increase or decrease in the value of the assets to which the guarantee applies.

AG28. Two examples of financial instruments that give rise to equity price risk are (a) a holding of equities in another entity, and (b) an investment in a trust that in turn holds investments in equity instruments. Other examples include forward contracts and options to buy or sell specified quantities of an equity instrument and swaps that are indexed to equity prices. The fair values of such financial instruments are affected by changes in the market price of the underlying equity instruments.

AG29. In accordance with paragraph 47(a), the sensitivity of surplus or deficit (that arises, for example, from instruments measured at fair value through surplus or deficit) is disclosed separately from the sensitivity of net assets/equity (that arises, for example, from investments in equity instruments whose changes in fair value are presented in net assets/equity).

AG30. Financial instruments that an entity classifies as equity instruments are not remeasured. Neither surplus or deficit nor net assets/equity will be affected by the equity price risk of those instruments. Accordingly, no sensitivity analysis is required.

Derecognition (paragraphs 49C–49H)

Continuing Involvement (paragraph 49C)

AG31. The assessment of continuing involvement in a transferred financial asset for the purposes of the disclosure requirements in paragraphs 49E–49H is made at the level of the reporting entity. For example, if a controlled entity transfers to an unrelated third party a financial asset in which the controlling entity of the controlled entity has continuing involvement, the controlled entity does not include the controlling entity's involvement in the assessment of whether it has continuing involvement in the transferred asset in its separate or individual financial statements (i.e., when the controlled entity is the reporting entity). However, a controlling entity would include its continuing involvement (or that of another member of the group) in a financial asset transferred by its controlling entity in determining whether it has continuing involvement in the transferred asset in its consolidated financial statements (i.e., when the reporting entity is the group).

AG32. An entity does not have a continuing involvement in a transferred financial asset if, as part of the transfer, it neither retains any of the contractual rights or obligations inherent in the transferred financial asset nor acquires any new contractual rights or obligations relating to the transferred financial asset. An entity does not have continuing involvement in a transferred financial asset if it has neither an interest in the future performance of the transferred financial asset nor a responsibility under any circumstances to make payments in respect of the transferred financial asset in the future. The term 'payment' in this context does not include cash flows of the transferred financial asset that an entity collects and is required to remit to the transferee.

AG32A. When an entity transfers a financial asset, the entity may retain the right to service that financial asset for a fee that is included in, for example, a servicing contract. The entity assesses the servicing contract in accordance with the guidance in paragraphs 49C and AG32 to decide whether the entity has continuing involvement as a result of the servicing contract for the purposes of the disclosure requirements. For example, a servicer will have continuing involvement in the transferred financial asset for the purposes of the disclosure requirements if the servicing fee is dependent on the amount or timing of the cash flows collected from the transferred financial asset. Similarly, a servicer has continuing involvement for the purposes of the disclosure requirements if a fixed fee would not be paid in full because of non-performance of the transferred financial asset. In these examples, the servicer has an interest in the future performance of the transferred financial asset. This assessment is independent of whether the fee to be received is expected to compensate the entity adequately for performing the servicing.

AG33. Continuing involvement in a transferred financial asset may result from contractual provisions in the transfer agreement or in a separate agreement with the transferee or a third party entered into in connection with the transfer.

Transferred Financial Assets that are Not Derecognized in Their Entirety (paragraph 49D)

AG34. Paragraph 49D requires disclosures when part or all of the transferred financial assets do not qualify for derecognition. Those disclosures are required at each reporting date at which the entity continues to recognize the transferred financial assets, regardless of when the transfers occurred.

Types of Continuing Involvement (paragraphs 49E–49H)

AG35. Paragraphs 49E–49H require qualitative and quantitative disclosures for each type of continuing involvement in derecognized financial assets. An entity shall aggregate its continuing involvement into types that are representative of the entity's exposure to risks. For example, an entity may aggregate its continuing involvement by type of financial instrument (e.g., guarantees or call options) or by type of transfer (e.g., factoring of receivables, securitizations and securities lending).

Maturity Analysis for Undiscounted Cash Outflows to Repurchase Transferred Assets (paragraph 49E(e))

AG36. Paragraph 49E(e) requires an entity to disclose a maturity analysis of the undiscounted cash outflows to repurchase derecognized financial assets or other amounts payable to the transferee in respect of the derecognized financial assets, showing the remaining contractual maturities of the entity's continuing involvement. This analysis distinguishes cash flows that are required to be paid (e.g., forward contracts), cash flows that the entity may be required to pay (e.g., written put options) and cash flows that the entity might choose to pay (e.g., purchased call options).

AG37. An entity shall use its judgment to determine an appropriate number of time bands in preparing the maturity analysis required by paragraph 49E(e). For example, an entity might determine that the following maturity time bands are appropriate:

(a) Not later than one month;

(b) Later than one month and not later than three months;

(c) Later than three months and not later than six months;

(d) Later than six months and not later than one year;

(e) Later than one year and not later than three years;

(f) Later than three years and not later than five years; and

(g) More than five years.

AG38. If there is a range of possible maturities, the cash flows are included on the basis of the earliest date on which the entity can be required or is permitted to pay.

Qualitative Information (paragraph 49E(f))

AG39. The qualitative information required by paragraph 49E(f) includes a description of the derecognized financial assets and the nature and purpose of the continuing involvement retained after transferring those assets. It also includes a description of the risks to which an entity is exposed, including:

(a) A description of how the entity manages the risk inherent in its continuing involvement in the derecognized financial assets.

(b) Whether the entity is required to bear losses before other parties, and the ranking and amounts of losses borne by parties whose interests rank lower than the entity's interest in the asset (i.e., its continuing involvement in the asset).

(c) A description of any triggers associated with obligations to provide financial support or to repurchase a transferred financial asset.

Gain or Loss on Derecognition (paragraph 49G(a))

AG40. Paragraph 49G(a) requires an entity to disclose the gain or loss on derecognition relating to financial assets in which the entity has continuing involvement. The entity shall disclose if a gain or loss on derecognition arose because the fair values of the components of the previously recognized asset (i.e., the interest in the asset derecognized and the interest retained by the entity) were different from the fair value of the previously recognized asset as a whole. In that situation, the entity shall also disclose whether the fair value measurements included significant inputs that were not based on observable market data, as described in paragraph 32.

Supplementary Information (paragraph 49H)

AG41. The disclosures required in paragraphs 49D–49G may not be sufficient to meet the disclosure objectives in paragraph 49B. If this is the case, the entity shall disclose whatever additional information is necessary to meet the disclosure objectives. The entity shall decide, in the light of its circumstances, how much additional information it needs to provide to satisfy the information needs of users and how much emphasis it places on different aspects of the additional information. It is necessary to strike a balance between burdening financial statements with excessive detail that may not assist users of financial statements and obscuring information as a result of too much aggregation.

Offsetting Financial Assets and Financial Liabilities (paragraphs 17A–17F)

Scope (paragraph 17A)

AG42. The disclosures in paragraphs 17B–17E are required for all recognized financial instruments that are set off in accordance with paragraph 47 of IPSAS 28. In addition, financial instruments are within the scope of the disclosure requirements in paragraphs 17B–17E if they are subject to an enforceable master netting arrangement or similar agreement that covers similar financial instruments and transactions, irrespective of whether the financial instruments are set off in accordance with paragraph 47 of IPSAS 28.

AG43. The similar agreements referred to in paragraphs 17A and AG42 include derivative clearing agreements, global master repurchase agreements, global master securities lending agreements, and any related rights to financial collateral. The similar financial instruments and transactions referred to in paragraph AG31 include derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, securities borrowing, and securities lending agreements. Examples of financial instruments that are not within the scope of paragraph 17A 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.

Disclosure of Quantitative Information for Recognized Financial Assets and Recognized Financial Liabilities within the Scope of Paragraph 17A (paragraph 17C)

AG44. Financial instruments disclosed in accordance with paragraph 17C may be subject to different measurement requirements (for example, a payable related to a repurchase agreement may be measured at amortized cost, while a derivative will be measured at fair value). An entity shall include instruments at their recognized amounts and describe any resulting measurement differences in the related disclosures.

Disclosure of the Gross Amounts of Recognized Financial Assets and Recognized Financial Liabilities within the Scope of Paragraph 17A (paragraph 17C(a))

AG45. The amounts required by paragraph 17C(a) relate to recognized financial instruments that are set off in accordance with paragraph 47 of IPSAS 28. The amounts required by paragraph 17C(a) also relate to recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreement irrespective of whether they meet the offsetting criteria. However, the disclosures required by paragraph 17C(a) do not relate to any amounts recognized as a result of collateral agreements that do not meet the offsetting criteria in paragraph 47 of IPSAS 28. Instead, such amounts are required to be disclosed in accordance with paragraph 17C(d).

Disclosure of the Amounts that are Set Off in Accordance with the Criteria in Paragraph 47 of IPSAS 28 (paragraph 17C(b))

AG46. Paragraph 17C(b) requires that entities disclose the amounts set off in accordance with paragraph 47 of IPSAS 28 when determining the net amounts presented in the statement of financial position. The amounts of both the recognized financial assets and the recognized financial liabilities that are subject to set-off under the same arrangement will be 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 recognized derivative asset and a recognized derivative liability that meet the offsetting criteria in paragraph 47 of IPSAS 28. 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 paragraph 17C(a)) and the entire amount of the derivative liability (in accordance with paragraph 17C(b)). However, while the financial liability disclosure table will include the entire amount of the derivative liability (in accordance with paragraph 17C(a)), it will only include the amount of the derivative asset (in accordance with paragraph 17(b)) that is equal to the amount of the derivative liability.

Disclosure of the Net Amounts Presented in the Statement of Financial Position (paragraph 17C(c))

AG47. If an entity has instruments that meet the scope of these disclosures (as specified in paragraph 17A), but that do not meet the offsetting criteria in paragraph 47 of IPSAS 28, the amounts required to be disclosed by paragraph 17C(c) would equal the amounts required to be disclosed by paragraph 17C(a).

AG48. The amounts required to be disclosed by paragraph 17C(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 17C(c) back to the individual line item amounts presented in the statement of financial position.

Disclosure of the Amounts Subject to an Enforceable Master Netting Arrangement or Similar Agreement that are not Otherwise Included in Paragraph 17C(b) (paragraph 17C(d))

AG49. Paragraph 17C(d) requires that entities disclose amounts that are subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 17C(b). Paragraph 17C(d)(i) refers to amounts related to recognized financial instruments that do not meet some or all of the offsetting criteria in paragraph 47 of IPSAS 28 (for example, current rights of set-off that do not meet the criterion in paragraph 47(b) of IPSAS 28, or conditional rights of set-off that are enforceable and exercisable only in the event of default, or only in the event of insolvency or bankruptcy of any of the counterparties).

AG50. Paragraph 17C(d)(ii) refers to amounts related to financial collateral, including cash collateral, both received and pledged. An entity shall disclose the fair value of those financial instruments that have been pledged or received as collateral. The amounts disclosed in accordance with paragraph 17C(d)(ii) should relate to the actual collateral received or pledged and not to any resulting payables or receivables recognized to return or receive back such collateral.

Limits on the Amounts Disclosed in Paragraph 17C(d) (paragraph 17D)

AG51. When disclosing amounts in accordance with paragraph 17C(d), an entity must take into account the effects of over-collateralization by financial instrument. To do so, the entity must first deduct the amounts disclosed in accordance with paragraph 17C(d)(i) from the amount disclosed in accordance with paragraph 17C(c). The entity shall then limit the amounts disclosed in accordance with paragraph 17C(d)(ii) to the remaining amount in paragraph 17C(c) for the related financial instrument. However, if rights to collateral can be enforced across financial instruments, such rights can be included in the disclosure provided in accordance with paragraph 17D.

Description of the Rights of Set-Off Subject to Enforceable Master Netting Arrangements and Similar Agreements (paragraph 17E)

AG52. An entity shall describe the types of rights of set-off and similar arrangements disclosed in accordance with paragraph 17C(d), including the nature of those rights. For example, an entity shall describe its conditional rights. For instruments subject to rights of set-off that are not contingent on a future event but that do not meet the remaining criteria in paragraph 47 of IPSAS 28, the entity shall describe the reason(s) why the criteria are not met. For any financial collateral received or pledged, the entity shall describe the terms of the collateral agreement (for example, when the collateral is restricted).

Disclosure by Type of Financial Instrument or by Counterparty

AG53. The quantitative disclosures required by paragraph 17C(a)–(e) may be grouped by type of financial instrument or transaction (for example, derivatives, repurchase and reverse repurchase agreements or securities borrowing and securities lending agreements).

AG54. Alternatively, an entity may group the quantitative disclosures required by paragraph 17C(a)–(c) by type of financial instrument, and the quantitative disclosures required by paragraph 17C(c)–(e) by counterparty. If an entity provides the required information by counterparty, the entity is not required to identify the counterparties by name. However, designation of counterparties (Counterparty A, Counterparty B, Counterparty C, etc.) shall remain consistent from year to year for the years presented to maintain comparability. Qualitative disclosures shall be considered so that further information can be given about the types of counterparties. When disclosure of the amounts in paragraph 17C(c)–(e) is provided by counterparty, amounts that are individually significant in terms of total counterparty amounts shall be separately disclosed and the remaining individually insignificant counterparty amounts shall be aggregated into one line item.

Other

AG55. The specific disclosures required by paragraphs 17C–17E are minimum requirements. To meet the objective in paragraph 17B an entity may need to supplement them with additional (qualitative) disclosures, depending on the terms of the enforceable master netting arrangements and related agreements, including the nature of the rights of set-off, and their effect or potential effect on the entity's financial position.

Appendix B

Amendments to Other IPSASs

[Deleted]

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 30.

Introduction

BC1. This Basis for Conclusions summarizes the IPSASB's considerations in reaching the conclusions in IPSAS 30, *Financial Instruments: Disclosures*. As this Standard is based on IFRS 7, *Financial Instruments: Disclosures* issued by the IASB, the Basis for Conclusions outlines only those areas where IPSAS 30 departs from the main requirements of IFRS 7.

BC2. This project on financial instruments is noted as a key part of the IPSASB's convergence program which aims to converge IPSASs with IFRSs.

BC3. In developing this Standard, the IPSASB agreed to retain the existing text of IFRS 7 wherever consistent with existing IPSASs, except to deal with any public sector specific issues which result in adding or deleting disclosures.

BC4. In September 2007, the IASB issued amendments to IAS 1, *Presentation of Financial Statements* which introduced a new component into the presentation of financial statements called "comprehensive income." As the IPSASB has not yet considered this, along with some of the other amendments proposed in IAS 1, those amendments have not been included in IPSAS 30.

Concessionary Loans

BC5. Concessionary loans are granted to or received by an entity on below market terms. Examples of concessionary loans granted by entities include loans to developing countries, small farms, student loans granted to qualifying students for university or college education, and housing loans granted to low income families. Such loans are a feature of the public sector and are often made to implement a government's or other public sector entity's social policies. The intention of a concessionary loan at the outset is to provide or receive resources on below market terms. For this reason, the IPSASB concluded that more comprehensive disclosures are required by public sector entities for concessionary loans and has included additional disclosure requirements for such loans in paragraph 37.

Revision of IPSAS 30 as a result of the IPSASB's *The Applicability of IPSASs*, issued in April 2016

BC6. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:

(a) Removes the standard paragraphs about the applicability of IPSASs to "public sector entities other than GBEs" from the scope section of each Standard;

(b) Replaces the term "GBE" with the term "commercial public sector entities", where appropriate; and

(c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.

Revision of IPSAS 30 as a result of *Improvements to IPSAS, 2019*

BC7. The amendments to paragraph AG5 update the guidance on accounting for financial guarantee contracts resulting from IPSAS 41, *Financial Instruments* which were inadvertently omitted when IPSAS 41 was issued. The IPSASB agreed to include these minor amendments in *Improvements to IPSAS, 2019*.

Revision of IPSAS 30 as a result of *COVID-19: Deferral of Effective Dates*

BC8. The IPSASB published *Improvements to IPSAS, 2019* in January 2020, which included amendments to IPSAS 30, *Financial Instruments: Disclosures*. At the time these amendments were finalized, the Board decided that an entity shall apply them for annual financial statements covering periods beginning on or after January 1, 2022.

BC9. In June 2020, the IPSASB discussed the effect of the COVID-19 pandemic on financial reporting. The Board noted that the pandemic has created significant pressures on the resources public sector entities might otherwise allocate to the implementation of these amendments.

BC10. The Board concluded that deferral during a time of significant disruption would provide much-needed operational relief to public sector entities. Therefore, the Board decided to propose a one-year deferral of the effective date of these amendments.

BC11. The Board did not propose any changes to the amendments other than the deferral of the effective date. Earlier application of the amendments will continue to be permitted.

Revision of IPSAS 30 as a result of *Improvements to IPSAS, 2021*

BC12. The IPSASB reviewed the revisions to IFRS 7, *Financial Instruments: Disclosures*, included in *Interest Rate Benchmark Reform* (Amendments to IFRS 9, IAS 39 and IFRS 7) issued by the IASB in September 2019, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions and concurred that there was no public sector specific reason for not adopting these amendments, henceforth labeled as *Interest Rate Benchmark Reform*.

BC13. The IPSASB reviewed the revisions to IFRS 7, *Financial Instruments*, included in *Interest Rate Benchmark Reform—Phase 2* (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16) issued by the IASB in August 2020, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions and concurred that there was no public sector specific reason for not adopting these amendments, henceforth labeled as *Interest Rate Benchmark Reform—Phase 2*.

IMPLEMENTATION GUIDANCE

CONTENTS

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 30.

Introduction

IG1. This guidance suggests possible ways to apply some of the disclosure requirements in IPSAS 30. The guidance does not create additional requirements.

IG2. For convenience, each disclosure requirement in this Standard is discussed separately. In practice, disclosures would normally be presented as an integrated package and individual disclosures might satisfy more than one requirement. For example, information about concentrations of risk might also convey information about exposure to credit or other risk.

IG3. [Deleted]

IG4. [Deleted]

Classes of Financial Instruments and Level of Disclosure (paragraphs 9 and AG1–AG3)

IG5. Paragraph AG3 states that "an entity decides in the light of its circumstances how much detail it provides to satisfy the requirements of this Standard, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics." To satisfy the requirements, an entity may not need to disclose all the information suggested in this guidance.

IG6. Paragraph 29(c) of IPSAS 1 requires an entity to "provide additional disclosures when compliance with the specific requirements in IPSASs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance."

Significance of Financial Instruments for Financial Position and Financial Performance (paragraphs 10–36, AG4 and AG5)[1]

IG7. [Deleted]

IG8. [Deleted]

IG9. [Deleted]

IG10. [Deleted]

IG11. [Deleted]

Defaults and Breaches (paragraphs 22 and 23)

IG12. Paragraphs 22 and 23 require disclosures when there are any defaults or breaches of loans payable. Any defaults or breaches may affect the classification of the liability as current or non-current in accordance with IPSAS 1.

Total Interest Expense (paragraph 24(b))

IG13. Total interest expense disclosed in accordance with paragraph 24(b) is a component of the finance costs, which paragraph 102(b) of IPSAS 1 requires to be presented separately in the statement of financial performance. The line item for finance costs may also include amounts associated with non-financial liabilities.

[1] IPSAS 41, *Financial Instruments* deleted paragraph AG4 of IPSAS 30.

Hedge Accounting (paragraphs 28A–28C)

IG13A. Paragraph 28A of IPSAS 30 requires that an entity discloses amounts related to items designated as hedging instruments in a tabular format. The following example illustrates how that information might be disclosed.

	Nominal amount of the hedging instrument	Carrying amount of the hedging instrument		Line item in the statement of financial position where the hedging instrument is located	Changes in fair value used for calculating hedge ineffectiveness for 20X1
		Assets	**Liabilities**		
Cash flow hedges					
Commodity price risk					
- Forward sales contracts	xx	xx	xx	Line item XX	xx
Fair value hedges					
Interest rate risk					
- Interest rate swaps	xx	xx	xx	Line item XX	xx
Foreign exchange risk					
- Foreign currency loan	xx	xx	xx	Line item XX	xx

IG13B. Paragraph 28B of IPSAS 30 requires that an entity discloses amounts related to items designated as hedged items in a tabular format. The following example illustrates how that information might be disclosed.

	Carrying amount of the hedged item		Accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item		Line item in the statement of financial position in which the hedged item is included	Change in value used for calculating hedge ineffective-ness for 20X1	Cash flow hedge reserve
	Assets	**Liabilities**	**Assets**	**Liabilities**			
Cash flow hedges							
Commodity price risk	n/a	n/a	n/a	n/a	n/a	xx	xx
- Forecast sales							
- Discontinued hedges (forecast sales)	n/a	n/a	n/a	n/a	n/a	n/a	xx
Fair value hedges							
Interest rate risk	–	xx	–	xx		xx	n/a
- Loan payable					Line item XX		
- Discontinued hedges (Loan payable)	–	xx	–	xx	Line item XX	n/a	n/a
Foreign exchange risk							
- Firm commitment	xx	xx	xx	xx	Line item XX	xx	n/a

IG13C. Paragraph 28C of IPSAS 30 requires that an entity disclose amounts that have affected the statement of financial performance as a result of applying hedge accounting in a tabular format. The following example illustrates how that information might be disclosed.

Cash flow hedges[a]	Separate line item recognized in surplus or deficit as a result of a hedge of a net position[b]	Change in the value of the hedging instrument recognized in net assets/equity	Hedge ineffective-ness recognized in surplus or deficit	Line item in surplus or deficit (that includes hedge ineffective-ness)	Amount reclassified from the cash flow hedge reserve to surplus or deficit	Line item affected in surplus or deficit because of the reclassification
Commodity price risk						
Commodity X	n/a	xx	xx	Line item XX	xx	Line item XX
- Discontinued hedge	n/a	n/a	n/a	n/a	xx	Line item XX

(a) The information disclosed in the statement of changes in net assets/equity (cash flow hedge reserve) should have the same level of detail as these disclosures.

(b) This disclosure only applies to cash flow hedges of foreign currency risk.

Fair value hedges	Ineffectiveness recognized in surplus or deficit	Line item(s) in surplus or deficit (that include(s) hedge ineffectiveness)
Interest rate risk	xx	Line item XX
Foreign exchange risk	xx	Line item XX

Fair Value (paragraphs 31–34)

IG14. IPSAS 30 requires disclosures about the level in the fair value hierarchy in which fair value measurements are categorized for assets and liabilities measured in the statement of financial position. A tabular format is required unless another format is more appropriate. An entity might disclose the following for assets to comply with paragraph 33(a). (Disclosure of comparative information is also required, but is not included in the following example).

Assets Measured at Fair Value

		Fair value measurement at end of the reporting period using:		
Description	**Dec 31, 20X2**	**Level 1 CU million**	**Level 2 CU million**	**Level 3 CU million**
Financial assets at fair value through surplus or deficit				
Trading securities	100	40	55	5
Trading derivatives	39	17	20	2
Financial assets at fair value through net assets/equity				
Equity investments	75	30	40	5
Total	214	87	115	12

Note: For liabilities, a similar table might be presented.

IG15. IPSAS 30 requires a reconciliation from beginning to ending balances for those assets and liabilities that are measured in the statement of financial position at fair value based on a valuation technique for which any significant input is not based on observable market data (Level 3). A tabular format is required unless another format is more appropriate. An entity might disclose the following for assets to comply with paragraph 33(b). (Disclosure of comparative information is also required, but is not included in the following example).

Assets Measured at Fair Value Based on Level 3

	Fair value measurement at the end of the reporting period			
	Financial assets at fair value through surplus or deficit		**Financial assets at fair value through net assets/equity**	**Total**
	Trading securities CU million	Trading derivatives CU million	Equity investments CU million	CU million
Opening balance	6	5	4	15
Total gains or losses				
in surplus or deficit	(2)	(2)	–	(4)
in net assets/ equity	–	–	(1)	(1)
Purchases	1	2	2	5
Issues	–	–	–	–
Settlements	–	(1)	–	(1)
Transfers out of Level 3	–	(2)	–	(2)
Closing balance	5	2	5	12
Total gains or losses for the period included in surplus or deficit for assets held at the end of the reporting period	(1)	(1)	–	(2)

(Note: For liabilities, a similar table might be presented.)

Gains or losses included in surplus or deficit for the period (above) are presented in revenue as follows:

	Revenue
Total gains or losses included in surplus or deficit for the period	(4)
Total gains or losses for the period included in surplus or deficit for assets held at the end of the reporting period	(2)

(Note: For liabilities, a similar table might be presented.)

IG16. The fair value at initial recognition of financial instruments that are not traded in active markets is determined in accordance with paragraph AG151 of IPSAS 41. However, when, after initial recognition, an entity will use a valuation technique that incorporates data not obtained from observable markets, there may be a difference between the transaction price at initial recognition and the amount determined at initial recognition using that valuation technique. In these circumstances, the difference will be recognized in surplus or deficit in subsequent periods in accordance with IPSAS 41 and the entity's accounting policy. Such recognition reflects changes in factors (including time) that market participants would consider in setting a price (see paragraph AG151 of IPSAS 41). Paragraph 33 requires disclosures in these circumstances. An entity might disclose the following to comply with paragraph 34:

Background

On January 1, 20X1 an entity purchases for CU15 million financial assets that are not traded in an active market. The entity has only one class of such financial assets.

The transaction price of CU15 million is the fair value at initial recognition.

After initial recognition, the entity will apply a valuation technique to establish the financial assets' fair value. This valuation technique includes variables other than data from observable markets.

At initial recognition, the same valuation technique would have resulted in an amount of CU14 million, which differs from fair value by CU1 million.

The entity has existing differences of CU5 million at January 1, 20X1.

Application of Requirements

The entity's 20X2 disclosure would include the following:

Accounting Policies

The entity uses the following valuation technique to determine the fair value of financial instruments that are not traded in an active market: [description of technique not included in this example]. Differences may arise between the fair value at initial recognition (which, in accordance with IPSAS 41, is generally the transaction price) and the amount determined at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy].

In the Notes to the Financial Statements

As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, in accordance with IPSAS 41, the fair value of an instrument at inception is generally the transaction price. If the transaction price differs from the amount determined at inception using the valuation technique, that difference is [description of the entity's accounting policy].

The differences yet to be recognized in surplus or deficit are as follows:

	Dec 31, X2	**Dec 31, X1**
	CU million	CU million
Balance at beginning of year	5.3	5.0
New transactions	–	1.0
Amounts recognized in surplus or deficit during the year	(0.7)	(0.8)
Other increases	–	0.2
Other decreases	(0.1)	(0.1)
Balance at end of year	4.5	5.3

Nature and Extent of Risks Arising from Financial Instruments (paragraphs 38–49 and AG6–AG30)

Qualitative Disclosures (paragraph 40)

IG17. The type of qualitative information an entity might disclose to meet the requirements in paragraph 40 includes, but is not limited to, a narrative description of:

(a) The entity's exposures to risk and how they arose. Information about risk exposures might describe exposures both gross and net of risk transfer and other risk-mitigating transactions.

(b) The entity's policies and processes for accepting, measuring, monitoring, and controlling risk, which might include:

   (i) The structure and organization of the entity's risk management function(s), including a discussion of independence and accountability;

   (ii) The scope and nature of the entity's risk reporting or measurement systems;

   (iii) The entity's policies for hedging or mitigating risk, including its policies and procedures for taking collateral; and

   (iv) The entity's processes for monitoring the continuing effectiveness of such hedges or mitigating devices.

(c) The entity's policies and procedures for avoiding excessive concentrations of risk.

IG18. Information about the nature and extent of risks arising from financial instruments is more useful if it highlights any relationship between financial instruments that can affect the amount, timing or uncertainty of an entity's future cash flows. The extent to which a risk exposure is altered by such relationships might be apparent to users from the disclosures required by this Standard, but in some cases further disclosures might be useful.

IG19. In accordance with paragraph 40(c), entities disclose any change in the qualitative information from the previous period and explain the reasons for the change. Such changes may result from changes in exposure to risk or from changes in the way those exposures are managed.

Quantitative Disclosures (paragraphs 41–49 and AG7–AG30)

IG20. Paragraph 41 requires disclosure of quantitative data about concentrations of risk. For example, concentrations of credit risk may arise from:

(a) Industry sectors. Thus, if an entity's counterparties are concentrated in one or more industry sectors (such as retail or wholesale), it would disclose separately exposure to risks arising from each concentration of counterparties.

(b) Credit rating or other measure of credit quality. Thus, if an entity's counterparties are concentrated in one or more credit qualities (such as secured loans or unsecured loans) or in one or more credit ratings (such as investment grade or speculative grade), it would disclose separately exposure to risks arising from each concentration of counterparties.

(c) Geographical distribution. Thus, if an entity's counterparties are concentrated in one or more geographical markets (such as Asia or Europe), it would disclose separately exposure to risks arising from each concentration of counterparties.

(d) A limited number of individual counterparties or groups of closely related counterparties.

Similar principles apply to identifying concentrations of other risks, including liquidity risk and market risk. For example, concentrations of liquidity risk may arise from the repayment terms of financial liabilities, sources of borrowing facilities or reliance on a particular market in which to realize liquid assets. Concentrations of foreign exchange risk may arise if an entity has a significant net open position in a single foreign currency, or aggregate net open positions in several currencies that tend to move together.

IG21. In accordance with paragraph AG8, disclosure of concentrations of risk includes a description of the shared characteristic that identifies each concentration. For example, the shared characteristic may refer to geographical distribution of counterparties by groups of countries, individual countries or regions within countries.

IG22. When quantitative information at the end of the reporting period is unrepresentative of the entity's exposure to risk during the period, paragraph 42 requires further disclosure. To meet this requirement, an entity might disclose the highest, lowest, and average amount of risk to which it was exposed during the period. For example, if an entity typically has a large exposure to a particular currency, but at year-end unwinds the position, the entity might disclose a graph that shows the exposure at various times during the period, or disclose the highest, lowest, and average exposures.

Credit Risk (paragraphs 42A–43, AG8A–AG10)

IG22A. The following examples illustrate possible ways in which an entity might provide the disclosures required by paragraphs 42A–42N of IPSAS 30. However, these illustrations do not address all possible ways of applying the disclosure requirements.

Illustrating the Application of Paragraphs 42H and 42I

IG22B. The following example illustrates one way of providing information about the changes in the loss allowance and the significant changes in the gross carrying amount of financial assets during the period that contributed to changes in the loss allowance as required by paragraphs 42H–42I. This example does not illustrate the requirements for financial assets that are purchased or originated credit-impaired.

Mortgage loans–loss allowance CU'000	**12-month expected credit losses**	**Lifetime expected credit losses (collectively assessed)**	**Lifetime expected credit losses (individually assessed)**	**Credit-impaired financial assets (lifetime expected credit losses)**
Loss allowance as at January 1	**X**	**X**	**X**	**X**
Changes due to financial instruments recognized as at January 1:				
- Transfer to lifetime expected credit losses	(X)	X	X	–
- Transfer to credit-impaired financial assets	(X)	–	(X)	X
- Transfer to 12-month expected credit losses	X	(X)	(X)	–
- Financial assets that have been derecognized during the period	(X)	(X)	(X)	(X)
New financial assets originated or purchased	X	–	–	–
Write-offs	–	–	(X)	(X)
Changes in models/risk parameters	X	X	X	X
Foreign exchange and other movements	X	X	X	X
Loss allowance as at December 31	**X**	**X**	**X**	**X**

Significant changes in the gross carrying amount of mortgage loans that contributed to changes in the loss allowance were:

- The acquisition of Region Y's prime mortgage portfolio increased the residential mortgage book by x percent, with a corresponding increase in the loss allowance measured on a 12-month basis.
- The write off of the CUXX Region Z's mortgage portfolio following the collapse of the local market in the region reduced the loss allowance for financial assets with objective evidence of impairment by CUX.
- The expected increase in unemployment in Region X caused a net increase in financial assets whose loss allowance is equal to lifetime expected credit losses and caused a net increase of CUX in the lifetime expected credit losses allowance.

The significant changes in the gross carrying amount of mortgage loans are further explained below:

Mortgage loans–gross carrying amount CU'000	**12-month expected credit losses**	**Lifetime expected credit losses (collectively assessed)**	**Lifetime expected credit losses (individually assessed)**	**Credit-impaired financial assets (lifetime expected credit losses)**
Gross carrying amount as at January 1	**X**	**X**	**X**	**X**
Individual financial assets transferred to lifetime expected credit losses	(X)	–	X	–
Individual financial assets transferred to credit-impaired financial assets	(X)	–	(X)	X
Individual financial assets transferred from credit-impaired financial assets	X	–	X	(X)
Financial assets assessed on collective basis	(X)	X	–	–
New financial assets originated or purchased	X	–	–	–
Write-offs	–	–	(X)	(X)
Financial assets that have been derecognized	(X)	(X)	(X)	(X)
Changes due to modifications that did not result in derecognition	(X)	–	(X)	(X)
Other changes	X	X	X	X
Gross carrying amount as at December 31	**X**	**X**	**X**	**X**

Illustrating the Application of Paragraphs 42M and 42N

IG22C. The following example illustrates some ways of providing information about an entity's credit risk exposure and significant credit risk concentrations in accordance with paragraph 42M of IPSAS 30. The number of grades used to disclose the information in accordance with paragraph 42M of IPSAS 30 shall be consistent with the number that the entity uses to report internally to key management personnel for internal credit risk management purposes. However, if information about credit risk rating grades is not available without undue cost or effort and an entity uses past due information to assess whether credit risk has increased significantly since initial recognition in accordance with paragraph 83 of IPSAS 41, the entity shall provide an analysis by past due status for those financial assets.

Loan credit risk exposure by internal rating grades

20XX	**Mortgage Loans**		**Agriculture Loans**	
CU'000	**Gross carrying amount**		**Gross carrying amount**	
	Lifetime	**12-month**	**Lifetime**	**12-month**
Internal Grade 1–2	X	X	X	X
Internal Grade 3–4	X	X	X	X
Internal Grade 5–6	X	X	X	X
Internal Grade 7	X	X	X	X
Total	**X**	**X**	**X**	**X**

Loan credit risk profile by external rating grades

20XX	**Mortgage Loans**		**Agriculture Loans**	
CU'000	**Gross carrying amount**		**Gross carrying amount**	
	Lifetime	**12-month**	**Lifetime**	**12-month**
AAA-AA	X	X	X	X
A	X	X	X	X
BBB-BB	X	X	X	X
B	X	X	X	X
CCC-CC	X	X	X	X
C	X	X	X	X
D	X	X	X	X
Total	**X**	**X**	**X**	**X**

Loan risk profile by probability of default

20XX	**Mortgage Loans**		**Agriculture Loans**	
CU'000	**Gross carrying amount**		**Gross carrying amount**	
	Lifetime	**12-month**	**Lifetime**	**12-month**
0.00 – 0.10	X	X	X	X
0.11 – 0.40	X	X	X	X
0.41 – 1.00	X	X	X	X
1.01 – 3.00	X	X	X	X
3.01 – 6.00	X	X	X	X
6.01 – 11.00	X	X	X	X
11.01 – 17.00	X	X	X	X
17.01 – 25.00	X	X	X	X
25.01 – 50.00	X	X	X	X
50.01+	X	X	X	X
Total	**X**	**X**	**X**	**X**

IG22D. The Department of Agriculture provides short-term financing to both small-scale and large-scale farmers. The purpose of the financing is to purchase inputs such as fertilizers, seeds and pesticides. The Department of Agriculture discloses its small-scale farmers financing and large-scale farmers financing as separate classes of financial instruments and applies the simplified approach to its trade receivables so that the loss allowance is always measured at an amount equal to lifetime expected credit losses. The following table illustrates the use of a provision matrix as a risk profile disclosure under the simplified approach:

20XX CU'000			Trade receivables days past due		
Small-scale farmers financing	**Current**	**More than 30 days**	**More than 60 days**	**More than 90 days**	**Total**
Expected credit loss rate	0.10%	2%	5%	13%	
Estimated total gross carrying amount at default	CU20,777	CU1,416	CU673	CU235	CU23,101
Lifetime expected credit losses—small-scale farmers financing	CU21	CU28	CU34	CU31	CU114
Large-scale farmers financing					
Expected credit loss rate	0.20%	3%	8%	15%	
Estimated total gross carrying amount at default	CU19,222	CU2,010	CU301	CU154	CU21,687
Lifetime expected credit losses— large-scale farmers financing	CU38	CU60	CU24	CU23	CU145

Credit Risk (paragraphs 43–45, AG9 and AG10)

IG23. Paragraph 43 requires an entity to disclose information about its exposure to credit risk by class of financial instrument. Financial instruments in the same class share economic characteristics with respect to the risk being disclosed (in this case, credit risk). For example, an entity might determine that residential mortgages, unsecured agricultural loans, and research and development loans each have different economic characteristics.

Collateral and Other Credit Enhancements Pledged (paragraph 43(b))

IG24. Paragraph 43(b) requires an entity to describe collateral available as security for assets it holds and other credit enhancements obtained. An entity might meet this requirement by disclosing:

(a) The policies and processes for valuing and managing collateral and other credit enhancements obtained;

(b) A description of the main types of collateral and other credit enhancements (examples of the latter being guarantees, credit derivatives, and netting agreements that do not qualify for offset in accordance with IPSAS 28);

(c) The main types of counterparties to collateral and other credit enhancements and their creditworthiness; and

(d) Information about risk concentrations within the collateral or other credit enhancements.

IG25. [Deleted]

IG26. [Deleted]

IG27. [Deleted]

IG28. [Deleted]

IG29. [Deleted]

IG30. [Deleted]

IG31. [Deleted]

Market Risk (paragraphs 47–49 and AG19–AG30)

IG32. Paragraph 47(a) requires a sensitivity analysis for each type of market risk to which the entity is exposed. There are three types of market risk: interest rate risk, currency risk, and other price risk. Other price risk may include risks such as equity price risk, commodity price risk, prepayment risk (i.e., the risk that one party to a financial asset will incur a financial loss because the other party repays earlier or later than expected), and residual value risk (e.g., a lessor of motor cars that writes residual value guarantees is exposed to residual value risk). Risk variables that are relevant to disclosing market risk include, but are not limited to:

(a) The yield curve of market interest rates. It may be necessary to consider both parallel and non-parallel shifts in the yield curve.

(b) Foreign exchange rates.

(c) Prices of equity instruments.

(d) Market prices of commodities.

IG33. Paragraph 47(a) requires the sensitivity analysis to show the effect on surplus or deficit and net assets/equity of reasonably possible changes in the relevant risk variable. For example, relevant risk variables might include:

(a) Prevailing market interest rates, for interest-sensitive financial instruments such as a variable rate loan; or

(b) Currency rates and interest rates, for foreign currency financial instruments such as foreign currency bonds.

IG34. For interest rate risk, the sensitivity analysis might show separately the effect of a change in market interest rates on:

(a) Interest revenue and expense;

(b) Other line items of surplus or deficit (such as trading gains and losses); and

(c) When applicable, net assets/equity.

An entity might disclose a sensitivity analysis for interest rate risk for each currency in which the entity has material exposures to interest rate risk.

IG35. Because the factors affecting market risk vary depending on the specific circumstances of each entity, the appropriate range to be considered in providing a sensitivity analysis of market risk varies for each entity and for each type of market risk.

IG36. The following example illustrates the application of the disclosure requirement in paragraph 47(a):

Interest Rate Risk

At December 31, 20X2, if interest rates at that date had been 10 basis points lower with all other variables held constant, surplus for the year would have been CU1.7 million (20X1—CU2.4 million) higher, arising mainly as a result of lower interest expense on variable borrowings. If interest rates had been 10 basis points higher, with all other variables held constant, surplus would have been CU1.5 million (20X1—CU2.1 million) lower, arising mainly as a result of higher interest expense on variable borrowings. Surplus is more sensitive to interest rate decreases than increases because of borrowings with capped interest rates. The sensitivity is lower in 20X2 than in 20X1 because of a reduction in outstanding borrowings that has occurred as the entity's debt has matured (see note X).[a]

Foreign Currency Exchange Rate Risk

At December 31, 20X2, if the CU had weakened 10 percent against the US dollar with all other variables held constant, surplus for the year would have been CU2.8 million (20X1—CU6.4 million) lower, revenue would have been CU1.2 million (20X1—CU1.1 million) higher. Conversely, if the CU had strengthened 10 percent against the US dollar with all other variables held constant, surplus would have been CU2.8 million (20X1—CU6.4 million) higher, revenue would have been CU1.2 million (20X1—CU1.1 million) lower. The lower foreign currency exchange rate sensitivity in surplus in 20X2 compared with 20X1 is attributable to a reduction in foreign currency denominated debt. Revenue is more sensitive in 20X2 than in 20X1 because of the increased use of hedges of foreign currency purchases, offset by the reduction in foreign currency debt.

(a) Paragraph 46 requires disclosure of a maturity analysis of liabilities.

Other Market Risk Disclosures (paragraph 49)

IG37. Paragraph 49 requires the disclosure of additional information when the sensitivity analysis disclosed is unrepresentative of a risk inherent in a financial instrument. For example, this can occur when:

(a) A financial instrument contains terms and conditions whose effects are not apparent from the sensitivity analysis (e.g., options that remain out of (or in) the money for the chosen change in the risk variable);

(b) Financial assets are illiquid (e.g., when there is a low volume of transactions in similar assets and an entity finds it difficult to find a counterparty); or

(c) An entity has a large holding of a financial asset that, if sold in its entirety, would be sold at a discount or premium to the quoted market price for a smaller holding.

IG38. In the situation in paragraph IG37(a), additional disclosure might include:

(a) The terms and conditions of the financial instrument (e.g., the options);

(b) The effect on surplus or deficit if the term or condition were met (i.e., if the options were exercised); and

(c) A description of how the risk is hedged.

For example, an entity may acquire a zero cost interest rate collar that includes an out-of-the-money leveraged written option (e.g., the entity pays ten times the amount of the difference between a specified interest rate floor and the current market interest rate). The entity may regard the collar as an inexpensive economic hedge against a reasonably possible increase in interest rates. However, an unexpectedly large decrease in interest rates might trigger payments under the written option that, because of the leverage, might be significantly larger than the benefit of lower interest rates. Neither the fair value of the collar nor a sensitivity analysis based on reasonably possible changes in market variables would indicate this exposure. In this case, the entity might provide the additional information described above.

IG39. In the situation described in paragraph IG38(b), additional disclosure might include the reasons for the lack of liquidity and how the entity hedges the risk.

IG40. In the situation described in paragraph IG38(c), additional disclosure might include:

(a) The nature of the security (e.g., entity name);

(b) The extent of holding (e.g., 15 percent of the issued shares);

(c) The effect on surplus or deficit; and

(d) How the entity hedges the risk.

Derecognition (paragraphs 49D and 49E)

IG41. The following examples illustrate some possible ways to meet the quantitative disclosure requirements in paragraphs 49D and 49E.

IG42. The following examples illustrate how an entity that has adopted IPSAS 41 might meet the quantitative disclosure requirements in paragraphs 49D and 49E.

Transferred financial assets that are not derecognized in their entirety

Illustrating the application of paragraph 49D(d) and (e)

	Financial assets at fair value through surplus or deficit		**Financial assets at amortized cost**		**Financial assets at fair value through net assets/equity**
	CU million		CU million		CU million
	Trading assets	Derivatives	Mortgages	Consumer loans	Equity investments
Carrying amount of assets	X	X	X	X	X
Carrying amount of associated liabilities	(X)	(X)	(X)	(X)	(X)
For those liabilities that have recourse only to the transferred assets:					
Fair value of assets	X	X	X	X	X
Fair value of associated liabilities	(X)	(X)	(X)	(X)	(X)
Net position	X	X	X	X	X

Transferred financial assets that are derecognized in their entirety

Illustrating the application of paragraph 49E(a)–(d)

	Cash outflows to repurchase transferred (derecognized) assets	Carrying amount of continuing involvement in statement of financial position			Fair value of continuing involvement		Maximum exposure to loss
	CU million	CU million			CU million		CU million
Type of continuing involvement		**Financial assets at fair value through surplus or deficit**	**Financial assets at fair value through net assets/equity**	**Financial liabilities at fair value through surplus or deficit**	**Assets**	**Liabilities**	
Written put options	(X)			(X)		(X)	X
Purchased call options	(X)	X			X		X
Securities lending	(X)			(X)	X	(X)	X
Total		X		(X)	X	(X)	X

Illustrating the Application of Paragraph 49E(e)

Undiscounted cash flows to repurchase transferred assets								
	Maturity of continuing involvement CU million							
Type of continuing involvement	Total	less than 1 month	1–3 months	3–6 months	6 months – 1 year	1–3 years	3–5 years	more than 5 years
Written put options	X		X	X	X	X		
Purchased call options	X			X	X	X		X
Securities lending	X	X	X					

IG43. The following examples illustrate how an entity that has not adopted IPSAS 41 might meet the quantitative disclosure requirements in paragraphs 49D and 49E.

Transferred financial assets that are not derecognized in their entirety

Illustrating the application of paragraph 49D(d) and (e)

	Financial assets at fair value through surplus or deficit		Loans and receivables		Available-for-sale financial assets
	CU million		CU million		CU million
	Trading securities	Derivatives	Mortgages	Consumer loans	Equity investments
Carrying amount of assets	X	X	X	X	X
Carrying amount of associated liabilities	(X)	(X)	(X)	(X)	(X)
For those liabilities that have recourse only to the transferred assets:					
Fair value of assets	X	X	X	X	X
Fair value of associated liabilities	(X)	(X)	(X)	(X)	(X)
Net position	X	X	X	X	X

Transferred financial assets that are derecognized in their entirety

Illustrating the application of paragraph 49E(a)–(d)

	Cash outflows to repurchase transferred (derecognized) assets	Carrying amount of continuing involvement in statement of financial position			Fair value of continuing involvement		Maximum exposure to loss
	CU million	**CU million**			**CU million**		**CU million**
Type of continuing involvement		**Held for trading**	**Available-for-sale financial assets**	**Financial liabilities at fair value through surplus or deficit**	**Assets**	**Liabilities**	
Written put options	(X)			(X)		(X)	X
Purchased call options	(X)	X			X		X
Securities lending	(X)		X	(X)	X	(X)	X
Total		X	X	(X)	X	(X)	X

Illustrating the application of paragraph 49E(e)

Undiscounted cash flows to repurchase transferred assets								
			Maturity of continuing involvement CU million					
Type of continuing involvement	Total	less than 1 month	1–3 months	3–6 months	6 months –1 year	1–3 years	3–5 years	more than 5 years
Written put options	X		X	X	X	X		
Purchased call options	X			X	X	X		X
Securities lending	X	X	X					

Disclosures (paragraphs 17A–17F and AG42–55)

IG44. The following examples illustrate ways in which an entity might provide the quantitative disclosures required by paragraph 17C. However, these illustrations do not address all possible ways of applying the disclosure requirements as set out in paragraphs 17B–17E.

Background

An entity has entered into transactions subject to an enforceable master netting arrangement or similar agreement with the following counterparties. The entity has the following recognized financial assets and financial liabilities resulting from those transactions that meet the scope of the disclosure requirements in paragraph 17A.

Counterparty A:

The entity has a derivative asset (fair value of CU100 million) and a derivative liability (fair value of CU80 million) with Counterparty A that meet the offsetting criteria in paragraph 47 of IPSAS 28. Consequently, the gross derivative liability is set off against the gross derivative asset, resulting in the presentation of a net derivative asset of CU20 million in the entity's statement of financial position. Cash collateral has also been received from Counterparty A for a portion of the net derivative asset (CU10 million). The cash collateral of CU10 million does not meet the offsetting criteria in paragraph 47 of IPSAS 28, but it can be set off against the net amount of the derivative asset and derivative liability in the case of default and insolvency or bankruptcy, in accordance with an associated collateral arrangement.

Counterparty B:

The entity has a derivative asset (fair value of CU100 million) and a derivative liability (fair value of CU80 million) with Counterparty B that do not meet the offsetting criteria in paragraph 47 of IPSAS 28, but which the entity has the right to set off in the case of default and insolvency or bankruptcy. Consequently, the gross amount of the derivative asset (CU100 million) and the gross amount of the derivative liability (CU80 million) are presented separately in the entity's statement of financial position. Cash collateral has also been received from Counterparty B for the net amount of the derivative asset and derivative liability (CU20 million). The cash collateral of CU20 million does not meet the offsetting criteria in paragraph 47 of IPSAS 28, but it can be set off against the net amount of the derivative asset and derivative liability in the case of default and insolvency or bankruptcy, in accordance with an associated collateral arrangement.

Counterparty C:

The entity has entered into a sale and repurchase agreement with Counterparty C that is accounted for as a collateralized borrowing. The carrying amount of the financial assets (bonds) used as collateral and posted by the entity for the transaction is CU79 million and their fair value is CU85 million. The carrying amount of the collateralized borrowing (repo payable) is CU80 million.

The entity has also entered into a reverse sale and repurchase agreement with Counterparty C that is accounted for as a collateralized lending. The fair value of the financial assets (bonds) received as collateral (and not recognized in the entity's statement of financial position) is CU105 million. The carrying amount of the collateralized lending (reverse repo receivable) is CU90 million.

The transactions are subject to a global master repurchase agreement with a right of set-off only in default and insolvency or bankruptcy and therefore do not meet the offsetting criteria in paragraph 47 of IPSAS 28. Consequently, the related repo payable and repo receivable are presented separately in the entity's statement of financial position.

Illustrating the Application of Paragraph 17C(a)–(e) by Type of Financial Instrument

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at December 31, 20XX	(a)	(b)	(c)=(a)-(b)	(d)		(e)= (c)-(d)
				Related amounts not set off in the statement of financial position		
	Gross amounts of recognized financial assets	Gross amounts of recognized financial liabilities set off in the statement of financial position	Net amounts of financial assets presented in the statement of financial position	(d)(i), (d)(ii) Financial instruments	(d)(ii) Cash collateral received	Net amount
Description						
Derivatives	200	(80)	120	(80)	(30)	10
Reverse repurchase, securities borrowing and similar agreements	90	–	90	(90)	–	–
Other financial instruments	–	–	–	–	–	–
Total	290	(80)	210	(170)	(30)	10

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at December 31, 20XX	(a)	(b)	(c)=(a)-(b)	(d)		(e)= (c)-(d)
				Related amounts not set off in the statement of financial position		
	Gross amounts of recognized financial liabilities	Gross amounts of recognized financial assets set off in the statement of financial position	Net amounts of financial liabilities presented in the statement of financial position	(d)(i), (d)(ii) Financial instruments	(d)(ii) Cash collateral received	Net amount
Description						
Derivatives	160	(80)	80	(80)	–	–
Repurchase, securities lending and similar agreements	80	–	80	(80)	–	–
Other financial instruments	–	–	–	–	–	–
Total	240	(80)	160	(160)	–	–

Illustrating the Application of Paragraph 17C(a)–(c) by Type of Financial Instrument and Paragraph 17C(c)–(e) by Counterparty

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at December 31, 20XX	(a)	(b)	(c)=(a)-(b)
	Gross amounts of recognized financial assets	Gross amounts of recognized financial liabilities set off in the statement of financial position	Net amounts of financial assets presented in the statement of financial position
Description			
Derivatives	200	(80)	120
Reverse repurchase, securities borrowing and similar agreements	90	–	90
Other financial instruments	–	–	–
Total	290	(80)	210

Net financial assets subject to enforceable master netting arrangements and similar agreements, by counterparty

CU million

As at December 31, 20XX	(c)	(d)		(e)=(c)-(d)
		Related amounts not set off in the statement of financial position		
	Net amounts of financial assets presented in the statement of financial position	(d)(i), (d)(ii) Financial instruments	(d)(ii) Cash collateral received	Net amount
Counterparty A	20	–	(10)	10
Counterparty B	100	(80)	(20)	–
Counterparty C	90	(90)	–	–
Other	–	–	–	–
Total	210	(170)	(30)	10

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at December 31, 20XX	(a)	(b)	(c)=(a)-(b)
	Gross amounts of recognized financial liabilities	Gross amounts of recognized financial assets set off in the statement of financial position	Net amounts of financial liabilities presented in the statement of financial position
Description			
Derivatives	160	(80)	80
Repurchase, securities lending and similar agreements	80	–	80
Other financial instruments	–	–	–
Total	240	(80)	160

Net financial liabilities subject to enforceable master netting arrangements and similar agreements, by counterparty

CU million

As at December 31, 20XX	(c)	(d)		(e)=(c)-(d)
		Related amounts not set off in the statement of financial position		
	Net amounts of financial liabilities presented in the statement of financial position	(d)(i), (d)(ii) Financial instruments	(d)(ii) Cash collateral received	Net amount
Counterparty A	–	–	–	–
Counterparty B	80	(80)	–	–
Counterparty C	80	(80)	–	–
Other	–	–	–	–
Total	160	(160)	–	–

Transition from IPSAS 29 to IPSAS 41 (paragraphs 49K–49O)

IG45. The following illustration is an example of one possible way to meet the quantitative disclosure requirements in paragraphs 49K–49O of IPSAS 30 at the date of initial application of IPSAS 41. However, this illustration does not address all possible ways of applying the disclosure requirements of this Standard.

Reconciliation of statement of financial position balances from IPSAS 29 to IPSAS 41 at January 1, 2022

Financial assets	(i)	(ii)	(iii)	(iv) = (i) + (ii) + (iii)	(v) = (iii)
	IPSAS 29 carrying amount December 31, 2021 (1)	Reclassifications	Remeasurements	IPSAS 41 carrying amount January 1, 2022	Accumulated surplus or deficit effect on January 1, 2022 (2), (3)
Fair value through surplus or deficit					
Additions:					
From available for sale (IPSAS 29)	(a)			(c)	
From amortized cost (IPSAS 29) – required reclassification	(b)				
From amortized cost (IPSAS 29) – fair value option elected at January 1, 2022					
Subtractions:					
To amortized cost (IPSAS 41)					
To fair value through net assets/equity – debt instruments (IPSAS 41)					
To fair value through net assets/equity – equity instruments (IPSAS 41)					
Total change to fair value through surplus or deficit					
Fair value through net assets/equity					
Additions – debt instruments:					
From available for sale (IPSAS 29)				(g)	
From amortized cost (IPSAS 29)				(h)	
From fair value through surplus or deficit (IPSAS 29) – required reclassification based on classification criteria				(i)	
From fair value through surplus or deficit (fair value option under IPSAS 29) – fair value option criteria not met at January 1, 2022				(j)	
From fair value through surplus or deficit (IPSAS 29) – fair value option revoked at January 1, 2022 by choice				(k)	
Additions – equity instruments:					
From available-for-sale (IPSAS 29)					
From fair value through surplus or deficit (fair value option under IPSAS 29)–fair value through net assets/equity elected at January 1, 2022					
From cost (IPSAS 29)					
Subtractions – debt and equity instruments:					
Available for sale (IPSAS 29) to fair value through surplus or deficit (IPSAS 41) – required reclassification based on classification criteria				(d)	
Available for sale (IPSAS 29) to fair value through surplus or deficit (IPSAS 41) – fair value option elected at January 1, 2022					
Available for sale (IPSAS 29) to amortized cost (IPSAS 41)				(e)	
Total change to fair value through net assets/equity					
Amortized cost					
Additions:					
From available for sale (IPSAS 29)				(f)	
From fair value through surplus or deficit (IPSAS 29) – required reclassification					

Reconciliation of statement of financial position balances from IPSAS 29 to IPSAS 41 at January 1, 2022

Financial assets	**(i)**	**(ii)**	**(iii)**	**(iv) = (i) + (ii) + (iii)**	**(v) = (iii)**
	IPSAS 29 carrying amount December 31, 2021 (1)	**Reclassifications**	**Remeasurements**	**IPSAS 41 carrying amount January 1, 2022**	**Accumulated surplus or deficit effect on January 1, 2022 (2), (3)**
From fair value through surplus or deficit (fair value option under IPSAS 29) – fair value option criteria not met at January 1, 2022					
From fair value through surplus or deficit (IPSAS 29) – fair value option revoked at January 1, 2022 by choice					
Subtractions:					
To fair value through net assets/equity (IPSAS 41)				(l)	
To fair value through surplus or deficit (IPSAS 41) – required reclassification based on classification criteria					
To fair value through surplus or deficit (IPSAS 41)– fair value option elected at January 1, 2022					
Total change to amortized cost					
Total financial asset balances, reclassifications and remeasurements at January 1, 2022	**(i)**	**Total (ii) = 0**	**(iii)**	**(iv) = (i) + (ii) + (iii)**	

1 Includes the effect of reclassifying hybrid instruments that were bifurcated under IPSAS 29 with host contract components of (a), which had associated embedded derivatives with a fair value of X at December 31, 2021, and (b), which had associated embedded derivatives with a fair value of Y at December 31, 2021.

2 Includes (c), (d), (e) and (f), which are amounts reclassified from net assets/equity to accumulated surplus or deficit at the date of initial application.

3 Includes (g), (h), (i), (j), (k) and (l), which are amounts reclassified from accumulated surplus or deficit to net assets/equity at the date of initial application.

Comparison with IFRS 7

IPSAS 30, *Financial Instruments: Disclosures* is drawn primarily from IFRS 7, *Financial Instruments: Disclosures* (originally issued in 2005, including amendments published to April 2009). The main differences between IPSAS 30 and IFRS 7 are as follows:

- IPSAS 30 contains requirements related to concessionary loans. IFRS 7 does not require disclosures relating to concessionary loans.
- In certain instances, IPSAS 30 uses different terminology from IFRS 7. The most significant examples are the use of the terms "revenue," "statement of financial performance," and "net assets/equity" in IPSAS 30. The equivalent terms in IFRS 7 are "income," "statement of comprehensive income," and "equity."

IPSAS 31—INTANGIBLE ASSETS

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 38, *Intangible Assets* published by the International Accounting Standards Board (IASB). It also contains extracts from the Standing Interpretations Committee Interpretation 32 (SIC 32), *Intangible Assets—Web Site Costs*. Extracts from IAS 38 and SIC 32 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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IPSAS 31—INTANGIBLE ASSETS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 31, *Intangible Assets* was issued in January 2010.

Since then, IPSAS 31 has been amended by the following IPSASs:

- IPSAS 43, *Leases* (issued January 2022)
- *Improvements to IPSAS 2018* (issued October 2018)
- IPSAS 40, *Public Sector Combinations* (issued January 2017)
- IPSAS 39, *Employee Benefits* (issued July 2016)
- *Impairment of Revalued Assets* (Amendments to IPSAS 21, *Impairment of Non-Cash-Generating Assets*, and IPSAS 26, *Impairment of Cash-Generating Assets*) (issued July 2016)
- *The Applicability of IPSASs* (issued April 2016)
- *Improvements to IPSASs 2015* (issued April 2016)
- IPSAS 37, *Joint Arrangements* (issued January 2015)
- IPSAS 35, *Consolidated Financial Statements* (issued January 2015)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2014* (issued January 2015)
- IPSAS 32, *Service Concession Arrangements: Grantor* (issued October 2011)
- *Improvements to IPSASs 2011* (issued October 2011)

Table of Amended Paragraphs in IPSAS 31

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
3	Amended	Improvements to IPSASs April 2016 IPSAS 40 January 2017
4	Deleted	The Applicability of IPSASs April 2016
5	Deleted	The Applicability of IPSASs April 2016
6	Amended	IPSAS 37 January 2015 IPSAS 35 January 2015 IPSAS 32 October 2011 IPSAS 39 July 2016 IPSAS 40 January 2017 IPSAS 43 January 2022
9	Amended	IPSAS 43 January 2022
18	Amended	IPSAS 40 January 2017
18A	New	IPSAS 40 January 2017
24	Amended	IPSAS 40 January 2017

Paragraph Affected	How Affected	Affected By
26A	New	IPSAS 40 January 2017
28	Amended	Improvements to IPSASs April 2016
35	Amended	IPSAS 39 July 2016
39A	New	IPSAS 40 January 2017
39B	New	IPSAS 40 January 2017
39C	New	IPSAS 40 January 2017
39D	New	IPSAS 40 January 2017
39E	New	IPSAS 40 January 2017
40	Amended	IPSAS 40 January 2017
41	Amended	IPSAS 40 January 2017
64	Amended	IPSAS 39 July 2016
66	Amended	IPSAS 40 January 2017
67	Amended	IPSAS 40 January 2017
79	Amended	Improvements to IPSASs January 2015
91	Amended	Improvements to IPSASs January 2015
93A	New	IPSAS 40 January 2017
96	Amended	Improvements to IPSASs April 2016
97	Amended	Improvements to IPSASs January 2015
97A	New	Improvements to IPSASs January 2015
97B	New	Improvements to IPSASs January 2015
97C	New	Improvements to IPSASs January 2015
109	Amended	Improvements to IPSAS October 2018
110	Amended	Impairment of Revalued Assets July 2016
112	Amended	IPSAS 43 January 2022
113	Amended	IPSAS 43 January 2022
114A	New	IPSAS 40 January 2017
116	Amended	Improvements to IPSASs April 2016
117	Amended	Improvements to IPSASs April 2016 IPSAS 40 January 2017
129	Deleted	IPSAS 33 January 2015
130	Deleted	IPSAS 33 January 2015
131	Deleted	IPSAS 33 January 2015
131A	New	Improvements to IPSASs January 2015
132A	New	IPSAS 32 October 2011
132B	New	Improvements to IPSASs January 2015

Paragraph Affected	How Affected	Affected By
132C	New	IPSAS 33 January 2015
132D	New	IPSAS 37 January 2015 IPSAS 35 January 2015
132E	New	Improvements to IPSASs April 2016
132F	New	The Applicability of IPSASs April 2016
132G	New	Impairment of Revalued Assets July 2016
132H	New	IPSAS 39 July 2016
132I	New	IPSAS 40 January 2017
132J	New	Improvements to IPSAS October 2018
132K	New	IPSAS 43 January 2022
133	Amended	IPSAS 33 January 2015
AG6	Amended	IPSAS 43 January 2022

IPSAS 31—INTANGIBLE ASSETS

CONTENTS

International Public Sector Accounting Standard 31, *Intangible Assets*, is set out in paragraphs 1–133. All the paragraphs have equal authority. IPSAS 31 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard. This Standard requires an entity to recognize an intangible asset if, and only if, specified criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets, and requires specified disclosures about intangible assets.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for intangible assets.**

3. **This Standard shall be applied in accounting for intangible assets, except:**

   (a) **Intangible assets that are within the scope of another Standard;**

   (b) **Financial assets, as defined in IPSAS 28*, Financial Instruments: Presentation;***

   (c) **The recognition and measurement of exploration and evaluation assets (see the relevant international or national accounting standard dealing with exploration for, and evaluation of, mineral resources);**

   (d) **Expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources;**

   (e) [Deleted]

   (f) [Deleted]

   (g) **Powers and rights conferred by legislation, a constitution, or by equivalent means;**

   (h) **Deferred tax assets (see the relevant international or national accounting standard dealing with income taxes);**

   (i) **Deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of the relevant international or national accounting standard dealing with insurance contracts. In cases where the relevant international or national accounting standard does not set out specific disclosure requirements for those intangible assets, the disclosure requirements in this Standard apply to those intangible assets; and**

   (j) [Deleted]

   (k) **In respect of intangible heritage assets. However, the disclosure requirements of paragraphs 115–127 apply to those heritage assets that are recognized.**

4. [Deleted]

5. [Deleted]

6. If another IPSAS prescribes the accounting for a specific type of intangible asset, an entity applies that IPSAS instead of this Standard. For example, this Standard does not apply to:

   (a) Intangible assets held by an entity for sale in the ordinary course of operations (see IPSAS 11, *Construction Contracts, and* IPSAS 12, *Inventories*);

   (b) Leases of intangible assets accounted for in accordance with IPSAS 43, *Leases*;

   (c) Assets arising from employee benefits (see IPSAS 39, *Employee Benefits*);

   (d) Financial assets as defined in IPSAS 28. The recognition and measurement of some financial assets are covered by IPSAS 34, *Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements* and IPSAS 36, *Investments in Associates and Joint Ventures*;

   (e) Recognition and initial measurement of service concession assets that are within the scope of IPSAS 32, *Service Concession Assets: Grantor*. However, this Standard applies to the subsequent measurement and disclosure of such assets; and

   (f) Goodwill (see IPSAS 40, *Public Sector Combinations*).

7. Some intangible assets may be contained in or on a physical substance such as a compact disc (in the case of computer software), legal documentation (in the case of a license or patent), or film. In determining whether an asset that incorporates

both intangible and tangible elements should be treated under IPSAS 17, *Property, Plant, and Equipment,* or as an intangible asset under this Standard, an entity uses judgement to assess which element is more significant. For example, the navigation software for a fighter aircraft is integral to the aircraft and is treated as property, plant and equipment. The same applies to the operating system of a computer. When the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

8. This Standard applies to, among other things, expenditure on advertising, training, start-up, research, and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (e.g., a prototype), the physical element of the asset is secondary to its intangible component, i.e., the knowledge embodied in it.

9. Rights held by a lessee under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents, and copyrights are within the scope of this Standard and are excluded from the scope of IPSAS 43.

10. Exclusions from the scope of a Standard may occur if activities or transactions are so specialized that they give rise to accounting issues that may need to be dealt with in a different way. Such issues arise in the accounting for expenditure on the exploration for, or development and extraction of, oil, gas, and mineral deposits in extractive industries, and in the case of insurance contracts. Therefore, this Standard does not apply to expenditure on such activities and contracts. However, this Standard applies to other intangible assets used (such as computer software), and other expenditure incurred (such as start-up costs), in extractive industries, or by insurers.

Intangible Heritage Assets

11. This Standard does not require an entity to recognize intangible heritage assets that would otherwise meet the definition of, and recognition criteria for, intangible assets. If an entity does recognize intangible heritage assets, it must apply the disclosure requirements of this Standard and may, but is not required to, apply the measurement requirements of this Standard.

12. Some intangible assets are described as intangible heritage assets because of their cultural, environmental, or historical significance. Examples of intangible heritage assets include recordings of significant historical events and rights to use the likeness of a significant public person on, for example, postage stamps or collectible coins. Certain characteristics, including the following, are often displayed by intangible heritage assets (although these characteristics are not exclusive to such assets):

    (a) Their value in cultural, environmental, and historical terms is unlikely to be fully reflected in a financial value based purely on a market price;

    (b) Legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale;

    (c) Their value may increase over time; and

    (d) It may be difficult to estimate their useful lives, which in some cases could be several hundred years.

13. Public sector entities may have large holdings of intangible heritage assets that have been acquired over many years and by various means, including purchase, donation, bequest, and sequestration. These assets are rarely held for their ability to generate cash inflows, and there may be legal or social obstacles to using them for such purposes.

14. Some intangible heritage assets have future economic benefits or service potential other than their heritage value, for example, royalties paid to the entity for use of an historical recording. In these cases, an intangible heritage asset may be recognized and measured on the same basis as other items of cash-generating intangible assets. For other intangible heritage assets, their future economic benefit or service potential is limited to their heritage characteristics. The existence of both future economic benefits and service potential can affect the choice of measurement base.

15. The disclosure requirements in paragraphs 117–124 require entities to make disclosures about recognized intangible assets. Therefore, entities that recognize intangible heritage assets are required to disclose in respect of those assets such matters as, for example:

    (a) The measurement basis used;

    (b) The amortization method used, if any;

    (c) The gross carrying amount;

    (d) The accumulated amortization at the end of the period, if any; and

    (e) A reconciliation of the carrying amount at the beginning and end of the period showing certain components thereof.

Definitions

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

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

Carrying amount is the amount at which an asset is recognized after deducting any accumulated amortization and accumulated impairment losses.

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

An intangible asset is an identifiable nonmonetary asset without physical substance.

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.

Intangible Assets

17. Entities frequently expend resources, or incur liabilities, on the acquisition, development, maintenance, or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes, or systems, licenses, intellectual property, and trademarks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, lists of users of a service, acquired fishing licenses, acquired import quotas, and relationships with users of a service.

Identifiability

18. Not all the items described in paragraph 17 meet the definition of an intangible asset, i.e., identifiability, control over a resource, and existence of future economic benefits or service potential. If an item within the scope of this Standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognized as an expense when it is incurred. However, if the item is acquired in an acquisition, it forms part of the goodwill recognized at the acquisition date (see paragraph 66).

18A. The definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill. Goodwill recognized in an acquisition is an asset representing the future economic benefits arising from other assets acquired in an acquisition that are not individually identified and separately recognized. The future economic benefits may result from synergy between the identifiable assets acquired or from assets that, individually, do not qualify for recognition in the financial statements.

19. **An asset is identifiable if it either:**

(a) **Is separable, i.e., is capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or**

(b) **Arises from binding arrangements (including rights from contracts or other legal rights), regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.**

20. For the purposes of this Standard, a binding arrangement describes an arrangement that confers similar rights and obligations on the parties to it as if it were in the form of a contract.

Control of an Asset

21. An entity controls an asset if the entity has the power to obtain the future economic benefits or service potential flowing from the underlying resource and to restrict the access of others to those benefits or that service potential. The capacity of an entity to control the future economic benefits or service potential from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits or service potential in some other way.

22. Scientific or technical knowledge may give rise to future economic benefits or service potential. An entity controls those benefits or that service potential if, for example, the knowledge is protected by legal rights such as copyrights, a restraint of trade agreement (where permitted), or by a legal duty on employees to maintain confidentiality.

23. An entity may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits or service potential from training. The entity may also expect that the staff will continue to make their skills available to the entity. However, an entity usually has insufficient control over the expected future economic benefits or service potential arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset. For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits or service potential expected from it, and it also meets the other parts of the definition.

24. An entity may have a portfolio of users of its services or its success rate in reaching intended users of its services and expect that, because of its efforts in building relationships with users of its services, those users will continue to use its services. However, in the absence of legal rights to protect, or other ways to control the relationships with users of a service or the loyalty of those users, the entity usually has insufficient control over the expected economic benefits or service potential from relationships with users of a service and loyalty for such items (e.g., portfolio of users of a service, market shares or success rates of a service, relationships with, and loyalty of, users of a service) to meet the definition of intangible assets. In the absence of legal rights to protect such relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of an acquisition) provide evidence that the entity is nonetheless able to control the expected future economic benefits or service potential flowing from the relationships with the users of a service. Because such exchange transactions also provide evidence that the relationships with users of a service are separable, those relationships meet the definition of an intangible asset.

Future Economic Benefits or Service Potential

25. The future economic benefits or service potential flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity. For example, the use of intellectual property in a production or service process may reduce future production or service costs or improve service delivery rather than increase future revenues (e.g., an on-line system that allows citizens to renew driving licenses more quickly on-line, resulting in a reduction in office staff required to perform this function while increasing the speed of processing).

Recognition and Measurement

26. The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:

    (a) The definition of an intangible asset (see paragraphs 17–25); and

    (b) The recognition criteria (see paragraphs 28–30).

    This requirement applies to the cost measured at recognition (the cost in an exchange transaction or to internally generate an intangible asset, or the fair value of an intangible asset acquired through a non-exchange transaction) and those incurred subsequently to add to, replace part of, or service it.

26A. Paragraphs 32–39 deal with the application of the recognition criteria to separately acquired intangible assets, and paragraphs 39A–39E deal with their application to intangible assets acquired in a public sector combination. Paragraphs 42–43 deal with the initial measurement of intangible assets acquired through non-exchange transactions, paragraphs 44–45 with exchanges of intangible assets, and paragraphs 46–48 with the treatment of internally generated goodwill. Paragraphs 49–65 deal with the initial recognition and measurement of internally generated intangible assets.

27. The nature of intangible assets is such that, in many cases, there are no additions to such an asset or replacements of part of it. Accordingly, most subsequent expenditures are likely to maintain the expected future economic benefits or service potential embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria in this Standard. In addition, it is often difficult to attribute subsequent expenditure directly to a particular intangible asset rather than to the entity's operations as a whole. Therefore, only rarely will subsequent expenditure—expenditure incurred after the initial recognition of an acquired intangible asset or after completion of an internally generated intangible asset—be recognized in the carrying amount of an asset. Consistent with paragraph 61, subsequent expenditure on brands, mastheads, publishing titles, lists users of a service, and items similar in substance (whether externally acquired or internally generated) is always recognized in surplus or deficit as incurred. This is because such expenditure cannot be distinguished from expenditure to develop the entity's operations as a whole.

28. **An intangible asset shall be recognized if, and only if:**

    (a) **It is probable that the expected future economic benefits or service potential that are attributable to the asset will flow to the entity; and**

    (b) **The cost or fair value of the asset can be measured reliably**[1]**.**

29. **An entity shall assess the probability of expected future economic benefits or service potential using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.**

30. An entity uses judgement to assess the degree of certainty attached to the flow of future economic benefits or service potential that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence.

31. **An intangible asset shall be measured initially at cost in accordance with paragraphs 32–43. Where an intangible asset is acquired through a non-exchange transaction, its initial cost at the date of acquisition, shall be measured at its fair value as at that date.**

Separate Acquisition

32. Normally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected future economic benefits or service potential embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits or service potential, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 28(a) is always considered to be satisfied for separately acquired intangible assets.

33. In addition, the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

34. The cost of a separately acquired intangible asset comprises:

    (a) Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and

    (b) Any directly attributable cost of preparing the asset for its intended use.

35. Examples of directly attributable costs are:

    (a) Costs of employee benefits (as defined in IPSAS 39) arising directly from bringing the asset to its working condition;

    (b) Professional fees arising directly from bringing the asset to its working condition; and

    (c) Costs of testing whether the asset is functioning properly.

36. Examples of expenditures that are not part of the cost of an intangible asset are:

    (a) Costs of introducing a new product or service (including costs of advertising and promotional activities);

    (b) Costs of conducting operations in a new location or with a new class of users of a service (including costs of staff training); and

    (c) Administration and other general overhead costs.

37. Recognition of costs in the carrying amount of an intangible asset ceases when the asset is in the condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an intangible asset are not included in the carrying amount of that asset. For example, the following costs are not included in the carrying amount of an intangible asset:

    (a) Costs incurred while an asset capable of operating in the manner intended by management has yet to be brought into use; and

    (b) Initial operating deficits, such as those incurred while demand for the asset's output builds up.

38. Some operations occur in connection with the development of an intangible asset, but are not necessary to bring the asset to the condition necessary for it to be capable of operating in the manner intended by management. These incidental

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[1] Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent. Paragraph BC16 of IPSAS 1 discusses the transitional approach to the explanation of reliability.

operations may occur before or during the development activities. Because incidental operations are not necessary to bring an asset to the condition necessary for it to be capable of operating in the manner intended by management, the revenue and related expenses of incidental operations are recognized immediately in surplus or deficit, and included in their respective classifications of revenue and expense.

39. If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognized as interest expense over the period of credit unless it is capitalized in accordance with the capitalization treatment permitted in IPSAS 5, *Borrowing Costs*.

Acquisition of an intangible asset as part of an acquisition (public sector combination)

39A. In accordance with IPSAS 40, if an intangible asset is acquired in an acquisition, the cost of that intangible asset is its fair value at the acquisition date. The fair value of an intangible asset will reflect market participants' expectations at the acquisition date about the probability that the expected future economic benefits or service potential embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits or service potential, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 28(a) is always considered to be satisfied for intangible assets acquired in acquisitions. If an asset acquired in an acquisition is separable or arises from binding arrangements (including rights from contracts or other legal rights), sufficient information exists to measure reliably the fair value of the asset. Thus, the reliable measurement criterion in paragraph 28(b) is always considered to be satisfied for intangible assets acquired in acquisitions.

39B. In accordance with this Standard and IPSAS 40, an acquirer recognizes at the acquisition date, separately from goodwill, an intangible asset of the acquired operation, irrespective of whether the asset had been recognized by the acquired operation before the acquisition. This means that the acquirer recognizes as an asset separately from goodwill an in-process research and development project of the acquired operation if the project meets the definition of an intangible asset. An acquired operation's in-process research and development project meets the definition of an intangible asset when it:

(a) Meets the definition of an asset; and

(b) Is identifiable, i.e., is separable or arises from binding arrangements (including rights from contracts or other legal rights).

Intangible asset acquired in an acquisition (public sector combination)

39C. If an intangible asset acquired in an acquisition is separable or arises from a binding arrangement (including rights from contracts or other legal rights), sufficient information exists to measure reliably the fair value of the asset. When, for the estimates used to measure an intangible asset's fair value, there is a range of possible outcomes with different probabilities that uncertainty enters into the measurement of the asset's fair value.

39D. An intangible asset acquired in an acquisition might be separable, but only together with a related binding arrangement, identifiable asset or liability. In such cases, the acquirer recognizes the intangible asset separately from goodwill, but together with the related item.

39E. The acquirer may recognize a group of complementary intangible assets as a single asset provided the individual assets have similar useful lives. For example, the terms 'brand' and 'brand name' are often used as synonyms for trademarks and other marks. However, the former are general marketing terms that are typically used to refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise.

Subsequent Expenditure on an Acquired In-process Research and Development Project

40. **Research or development expenditure that:**

(a) **Relates to an in-process research or development project acquired separately or in an acquisition and recognized as an intangible asset; and**

(b) **Is incurred after the acquisition of that project;**

shall be accounted for in accordance with paragraphs 52–60.

41. Applying the requirements in paragraphs 52–60 means that subsequent expenditure on an in-process research or development project acquired separately or in an acquisition and recognized as an intangible asset is:

(a) Recognized as an expense when incurred if it is research expenditure;

(b) Recognized as an expense when incurred if it is development expenditure that does not satisfy the criteria for recognition as an intangible asset in paragraph 55; and

(c) Added to the carrying amount of the acquired in-process research or development project if it is development expenditure that satisfies the recognition criteria in paragraph 55.

Intangible Assets Acquired through Non-Exchange Transactions

42. In some cases, an intangible asset may be acquired through a non-exchange transaction. This may happen when another public sector entity transfers to an entity in a non-exchange transaction, intangible assets such as airport landing rights, licenses to operate radio or television stations, import licenses or quotas or rights to access other restricted resources. A private citizen, for example a Nobel Prize winner, may bequeath his or her personal papers, including the copyright to his or her publications to the national archives (a public sector entity) in a non-exchange transaction.

43. Under these circumstances the cost of the item is its fair value at the date it is acquired. For the purposes of this Standard, the measurement at recognition of an intangible asset acquired through a non-exchange transaction, at its fair value consistent with the requirements of paragraph 74, does not constitute a revaluation. Accordingly, the revaluation requirements in paragraph 74, and the supporting commentary in paragraphs 75–86 only apply when an entity elects to revalue an intangible item in subsequent reporting periods.

Exchanges of Assets

44. One or more intangible assets may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an intangible asset is measured at fair value unless the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognize the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

45. Paragraph 28(b) specifies that a condition for the recognition of an intangible asset is that the cost of the asset can be measured reliably. The fair value of an intangible asset for which comparable market transactions do not exist is reliably measurable if:

(a) The variability in the range of reasonable fair value estimates is not significant for that asset: or

(b) The probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.

If an entity is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

Internally Generated Goodwill

46. **Internally generated goodwill shall not be recognized as an asset.**

47. In some cases, expenditure is incurred to generate future economic benefits or service potential, but it does not result in the creation of an intangible asset that meets the recognition criteria in this Standard. Such expenditure is often described as contributing to internally generated goodwill. Internally generated goodwill is not recognized as an asset because it is not an identifiable resource (i.e., it is not separable nor does it arise from binding arrangements (including rights from contracts or other legal rights) controlled by the entity that can be measured reliably at cost.

48. Differences between the market value of an entity and the carrying amount of its identifiable net assets at any time may capture a range of factors that affect the value of the entity. However, such differences do not represent the cost of intangible assets controlled by the entity.

Internally Generated Intangible Assets

49. It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition because of problems in:

(a) Identifying whether and when there is an identifiable asset that will generate expected future economic benefits or service potential; and

(b) Determining the cost of the asset reliably. In some cases, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the entity's internally generated goodwill or of running day-to-day operations.

Therefore, in addition to complying with the general requirements for the recognition and initial measurement of an intangible asset, an entity applies the requirements and guidance in paragraphs 50–65 to all internally generated intangible assets.

50. To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into:

(a) A research phase; and

(b) A development phase.

Although the terms "research" and "development" are defined, the terms "research phase" and "development phase" have a broader meaning for the purpose of this Standard.

51. If an entity cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the entity treats the expenditure on that project as if it were incurred in the research phase only.

Research Phase

52. **No intangible asset arising from research (or from the research phase of an internal project) shall be recognized. Expenditure on research (or on the research phase of an internal project) shall be recognized as an expense when it is incurred.**

53. In the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits or service potential. Therefore, this expenditure is recognized as an expense when it is incurred.

54. Examples of research activities are:

(a) Activities aimed at obtaining new knowledge;

(b) The search for, evaluation and final selection of, applications of research findings or other knowledge;

(c) The search for alternatives for materials, devices, products, processes, systems, or services; and

(d) The formulation, design, evaluation, and final selection of possible alternatives for new or improved materials, devices, products, processes, systems, or services.

Development Phase

55. **An intangible asset arising from development (or from the development phase of an internal project) shall be recognized if, and only if, an entity can demonstrate all of the following:**

(a) **The technical feasibility of completing the intangible asset so that it will be available for use or sale;**

(b) **Its intention to complete the intangible asset and use or sell it;**

(c) **Its ability to use or sell the intangible asset;**

(d) **How the intangible asset will generate probable future economic benefits or service potential. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;**

(e) **The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and**

(f) **Its ability to measure reliably the expenditure attributable to the intangible asset during its development.**

56. In the development phase of an internal project, an entity can, in some instances, identify an intangible asset and demonstrate that the asset will generate probable future economic benefits or service potential. This is because the development phase of a project is further advanced than the research phase.

57. Examples of development activities are:

(a) The design, construction, and testing of pre-production or pre-use prototypes and models;

(b) The design of tools, jigs, moulds, and dies involving new technology;

(c) The design, construction, and operation of a pilot plant or operation that is not of a scale economically feasible for commercial production or use in providing services;

(d) The design, construction, and testing of a chosen alternative for new or improved materials, devices, products, processes, systems, or services; and

(e) Website costs and software development costs.

58. To demonstrate how an intangible asset will generate probable future economic benefits or service potential, an entity assesses the future economic benefits or service potential to be received from the asset using the principles in either IPSAS 21, *Impairment of Non-Cash-Generating Assets* or IPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate. If the asset will generate economic benefits or service potential only in combination with other assets, the entity applies the concept of cash-generating units in IPSAS 26.

59. Availability of resources to complete, use, and obtain the benefits from an intangible asset can be demonstrated by, for example, an operating plan showing the technical, financial, and other resources needed and the entity's ability to secure those resources. In some cases, an entity demonstrates the availability of external finance by obtaining a lender's or funder's indication of its willingness to fund the plan.

60. An entity's costing systems can often measure reliably the cost of generating an intangible asset internally, such as salary and other expenditure incurred in securing logos, copyrights or licenses, or developing computer software.

61. **Internally generated brands, mastheads, publishing titles, lists of users of a service, and items similar in substance shall not be recognized as intangible assets.**

62. Expenditure on internally generated brands, mastheads, publishing titles, lists of users of a service, and items similar in substance cannot be distinguished from the cost of developing the entity's operations as a whole. Therefore, such items are not recognized as intangible assets.

Cost of an Internally Generated Intangible Asset

63. The cost of an internally generated intangible asset for the purpose of paragraph 31 is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraphs 28, 29, and 55. Paragraph 70 prohibits reinstatement of expenditure previously recognized as an expense.

64. The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. Examples of directly attributable costs are:

(a) Costs of materials and services used or consumed in generating the intangible asset;

(b) Costs of employee benefits (as defined in IPSAS 39) arising from the generation of the intangible asset;

(c) Fees to register a legal right; and

(d) Amortization of patents and licenses that are used to generate the intangible asset.

IPSAS 5 specifies criteria for the recognition of interest as an element of the cost of an asset that is a qualifying asset.

65. The following are not components of the cost of an internally generated intangible asset:

(a) Selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to preparing the asset for use;

(b) Identified inefficiencies and initial operating deficits incurred before the asset achieves planned performance; and

(c) Expenditure on training staff to operate the asset.

Recognition of an Expense

66. **Expenditure on an intangible item shall be recognized as an expense when it is incurred unless:**

(a) **It forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs 26–65); or**

(b) **The item is acquired in an acquisition and cannot be recognized as an intangible asset. If this is the case, it forms part of the amount recognized as goodwill at the acquisition date (see IPSAS 40).**

67. In some cases, expenditure is incurred to provide future economic benefits or service potential to an entity, but no intangible asset or other asset is acquired or created that can be recognized. In the case of the supply of goods, the entity recognizes

such expenditure as an expense when it has a right to access those goods. In the case of the supply of services, the entity recognizes the expenditure as an expense when it receives the services. For example, expenditure on research is recognized as an expense when it is incurred (see paragraph 52), except when it is acquired as part of an acquisition. Other examples of expenditure that is recognized as an expense when it is incurred include:

(a) Expenditure on start-up activities (i.e., start-up costs), unless this expenditure is included in the cost of an item of property, plant, and equipment in accordance with IPSAS 17. Start-up costs may consist of establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or operation (i.e., pre-opening costs), or expenditures for starting new operations or launching new products or processes (i.e., pre-operating costs);

(b) Expenditure on training activities;

(c) Expenditure on advertising and promotional activities (including mail order catalogues and information pamphlets); and

(d) Expenditure on relocating or reorganizing part or all of an entity.

68. An entity has a right to access goods when it owns them. Similarly, it has a right to access goods when they have been constructed by a supplier in accordance with the terms of a supply contract and the entity could demand delivery of them in return for payment. Services are received when they are performed by a supplier in accordance with a contract to deliver them to the entity and not when the entity uses them to deliver another service, for example, to deliver information about a service to users of that service.

69. Paragraph 66 does not preclude an entity from recognizing a prepayment as an asset when payment for goods has been made in advance of the entity obtaining a right to access those goods. Similarly, paragraph 66 does not preclude an entity from recognizing a prepayment as an asset when payment for services has been made in advance of the entity receiving those services.

Past Expenses not to be Recognized as an Asset

70. **Expenditure on an intangible item that was initially recognized as an expense under this Standard shall not be recognized as part of the cost of an intangible asset at a later date.**

Subsequent Measurement

71. **An entity shall choose either the cost model in paragraph 73 or the revaluation model in paragraph 74 as its accounting policy. If an intangible asset is accounted for using the revaluation model, all the other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets.**

72. A class of intangible assets is a grouping of assets of a similar nature and use in an entity's operations. The items within a class of intangible assets are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements representing a mixture of costs and values as at different dates.

Cost Model

73. **After initial recognition, an intangible asset shall be carried at its cost less any accumulated amortization and any accumulated impairment losses.**

Revaluation Model

74. **After initial recognition, an intangible asset shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortization and subsequent accumulated impairment losses. For the purpose of revaluations under this Standard, fair value shall be determined by reference to an active market. Revaluations shall be made with such regularity that at the reporting date the carrying amount of the asset does not differ materially from its fair value.**

75. The revaluation model does not allow:

(a) The revaluation of intangible assets that have not previously been recognized as assets; or

(b) The initial recognition of intangible assets at amounts other than cost.

76. The revaluation model is applied after an asset has been initially recognized at cost. However, if only part of the cost of an intangible asset is recognized as an asset because the asset did not meet the criteria for recognition until part of

the way through the process (see paragraph 63), the revaluation model may be applied to the whole of that asset. Also, the revaluation model may be applied to an intangible asset that was received through a non-exchange transaction (see paragraphs 42–43).

77. It is uncommon for an active market to exist for an intangible asset, although this may happen. For example, in some jurisdictions, an active market may exist for freely transferable homogeneous classes of licenses or production quotas the entity has acquired from another entity. However, an active market cannot exist for brands, newspaper mastheads, music and film publishing rights, patents, or trademarks, because each such asset is unique. Also, although intangible assets are bought and sold, contracts are negotiated between individual buyers and sellers, and transactions are relatively infrequent. For these reasons, the price paid for one asset may not provide sufficient evidence of the fair value of another. Moreover, prices are often not available to the public.

78. The frequency of revaluations depends on the volatility of the fair values of the intangible assets being revalued. If the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some intangible assets may experience significant and volatile movements in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for intangible assets with only insignificant movements in fair value.

79. When an intangible asset is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:

(a) The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. For example, the gross carrying amount may be restated by reference to observable market data or it may be restated proportionately to the change in the carrying amount. The accumulated amortization at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses; or

(b) The accumulated amortization is eliminated against the gross carrying amount of the asset.

The amount of the adjustment of accumulated amortization forms part of the increase or decrease in the carrying amount that is accounted for in accordance with paragraphs 84 and 85.

80. **If an intangible asset in a class of revalued intangible assets cannot be revalued because there is no active market for this asset, the asset shall be carried at its cost less any accumulated amortization and impairment losses.**

81. **If the fair value of a revalued intangible asset can no longer be determined by reference to an active market, the carrying amount of the asset shall be its revalued amount at the date of the last revaluation by reference to the active market less any subsequent accumulated amortization and any subsequent accumulated impairment losses.**

82. The fact that an active market no longer exists for a revalued intangible asset may indicate that the asset may be impaired and that it needs to be tested in accordance with IPSAS 21 or IPSAS 26, as appropriate.

83. If the fair value of the asset can be determined by reference to an active market at a subsequent measurement date, the revaluation model is applied from that date.

84. **If an intangible asset's carrying amount is increased as a result of a revaluation, the increase shall be credited directly to revaluation surplus. However, the increase shall be recognized in surplus or deficit to the extent that it reverses a revaluation decrease of the same asset previously recognized in surplus or deficit.**

85. **If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognized in surplus or deficit. However, the decrease shall be recognized directly in net assets/equity to the extent of any credit balance in the revaluation surplus in respect of that asset. The decrease recognized directly in net assets/equity reduces the amount accumulated in net assets/equity under the heading of revaluation surplus.**

86. The cumulative revaluation surplus included in net assets/equity may be transferred directly to accumulated surpluses or deficits when the surplus is realized. The whole surplus may be realized on the retirement or disposal of the asset. However, some of the surplus may be realized as the asset is used by the entity; in such a case, the amount of the surplus realized is the difference between amortization based on the revalued carrying amount of the asset and amortization that would have been recognized based on the asset's historical cost. The transfer from revaluation surplus to accumulated surpluses or deficits is not made through surplus or deficit.

Useful Life

87. **An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset shall be regarded by**

the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for, or provide service potential to, the entity.

88. The accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is amortized (see paragraphs 96–105), and an intangible asset with an indefinite useful life is not (see paragraphs 106–109). The Illustrative Examples accompanying this Standard illustrate the determination of useful life for different intangible assets, and the subsequent accounting for those assets based on the useful life determinations.

89. Many factors are considered in determining the useful life of an intangible asset, including:

(a) The expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;

(b) Typical product life cycles for the asset and public information on estimates of useful lives of similar assets that are used in a similar way;

(c) Technical, technological, commercial, or other types of obsolescence;

(d) The stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;

(e) Expected actions by competitors or potential competitors;

(f) The level of maintenance expenditure required to obtain the expected future economic benefits or service potential from the asset and the entity's ability and intention to reach such a level;

(g) The period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and

(h) Whether the useful life of the asset is dependent on the useful life of other assets of the entity.

90. The term "indefinite" does not mean "infinite." The useful life of an intangible asset reflects only that level of future maintenance expenditure required to maintain the asset at its standard of performance assessed at the time of estimating the asset's useful life, and the entity's ability and intention to reach such a level. A conclusion that the useful life of an intangible asset is indefinite should not depend on planned future expenditure in excess of that required to maintain the asset at that standard of performance.

91. Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it will often be the case that their useful life is short. Expected future reductions in the selling price of an item that was produced using an intangible asset could indicate the expectation of technological or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits or service potential embodied in the asset.

92. The useful life of an intangible asset may be very long or even indefinite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically short.

93. **The useful life of an intangible asset that arises from binding arrangements (including rights from contracts or other legal rights) shall not exceed the period of the binding arrangement (including rights from contracts or other legal rights), but may be shorter depending on the period over which the entity expects to use the asset. If the binding arrangements (including rights from contracts or other legal rights) are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost.**

93A. **The useful life of:**

(a) **A license or similar right previously granted by one combining operation to another combining operation that is recognized by the resulting entity in an amalgamation; or**

(b) **A reacquired right recognized as an intangible asset in an acquisition**

is the remaining period of the binding arrangement (including rights from contracts or other legal rights) in which the right was granted and shall not include renewal periods.

94. There may be economic, political, social, and legal factors influencing the useful life of an intangible asset. Economic, political, or social factors determine the period over which future economic benefits or service potential will be received by

the entity. Legal factors may restrict the period over which the entity controls access to such economic benefits or service potential. The useful life is the shorter of the periods determined by these factors.

95. Existence of the following factors, among others, indicates that an entity would be able to renew the binding arrangements (including rights from contracts or other legal rights) without significant cost:

(a) There is evidence, possibly based on experience, that the binding arrangements (including rights from contracts or other legal rights) will be renewed. If renewal is contingent upon the consent of a third party, this includes evidence that the third party will give its consent;

(b) There is evidence that any conditions necessary to obtain renewal will be satisfied; and

(c) The cost to the entity of renewal is not significant when compared with the future economic benefits or service potential expected to flow to the entity from renewal.

If the cost of renewal is significant when compared with the future economic benefits or service potential expected to flow to the entity from renewal, the "renewal" cost represents, in substance, the cost to acquire a new intangible asset at the renewal date.

Intangible Assets with Finite Useful Lives

Amortization Period and Amortization Method

96. **The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life. Amortization shall begin when the asset is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Amortization shall cease at the date that the asset is derecognized. The amortization method used shall reflect the pattern in which the asset's future economic benefits or service potential are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. The amortization charge for each period shall be recognized in surplus or deficit unless this or another Standard permits or requires it to be included in the carrying amount of another asset.**

97. A variety of amortization methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method, and the units of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits or service potential embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits or service potential.

97A. There is a rebuttable presumption that an amortization method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate. The revenue generated by an activity that includes the use of an intangible asset typically reflects factors that are not directly linked to the consumption of the economic benefits or service potential embodied in the intangible asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed. This presumption can be overcome only in the limited circumstances:

(a) In which the intangible asset is expressed as a measure of revenue, as described in paragraph 97C; or

(b) When it can be demonstrated that revenue and the consumption of the economic benefits or service potential of the intangible asset are highly correlated.

97B. In choosing an appropriate amortization method in accordance with paragraph 97, an entity could determine the predominant limiting factor that is inherent in the intangible asset. For example, the contract that sets out the entity's rights over its use of an intangible asset might specify the entity's use of the intangible asset as a predetermined number of years (i.e., time), as a number of units produced or as a fixed total amount of revenue to be generated. Identification of such a predominant limiting factor could serve as the starting point for the identification of the appropriate basis of amortization, but another basis may be applied if it more closely reflects the expected pattern of consumption of economic benefits or service potential.

97C. In the circumstance in which the predominant limiting factor that is inherent in an intangible asset is the achievement of a revenue threshold, the revenue to be generated can be an appropriate basis for amortization. For example, the right to operate a toll road could be based on a fixed total amount of revenue to be generated from cumulative tolls charged (for example, a contract could allow operation of the toll road until the cumulative amount of tolls generated from operating the road reaches CU100 million). In the case in which revenue has been established as the predominant limiting factor in the contract for the use of the intangible asset, the revenue that is to be generated might be an appropriate basis for amortizing the intangible asset, provided that the contract specifies a fixed total amount of revenue to be generated on which amortization is to be determined.

98. Amortization is usually recognized in surplus or deficit. However, sometimes the future economic benefits or service potential embodied in an asset are absorbed in producing other assets. In this case, the amortization charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the amortization of intangible assets used in a production process is included in the carrying amount of inventories (see IPSAS 12).

Residual Value

99. **The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:**

(a) **There is a commitment by a third party to acquire the asset at the end of its useful life; or**

(b) **There is an active market for the asset, and:**

(i) **Residual value can be determined by reference to that market; and**

(ii) **It is probable that such a market will exist at the end of the asset's useful life.**

100. The depreciable amount of an asset with a finite useful life is determined after deducting its residual value. A residual value other than zero implies that an entity expects to dispose of the intangible asset before the end of its economic life.

101. An estimate of an asset's residual value is based on the amount recoverable from disposal using prices prevailing at the date of the estimate for the sale of a similar asset that has reached the end of its useful life and has operated under conditions similar to those in which the asset will be used. The residual value is reviewed at least at each reporting date. A change in the asset's residual value is accounted for as a change in an accounting estimate in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.

102. The residual value of an intangible asset may increase to an amount equal to or greater than the asset's carrying amount. If it does, the asset's amortization charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount.

Review of Amortization Period and Amortization Method

103. **The amortization period and the amortization method for an intangible asset with a finite useful life shall be reviewed at least at each reporting date. If the expected useful life of the asset is different from previous estimates, the amortization period shall be changed accordingly. If there has been a change in the expected pattern of consumption of the future economic benefits or service potential embodied in the asset, the amortization method shall be changed to reflect the changed pattern. Such changes shall be accounted for as changes in accounting estimates in accordance with IPSAS 3.**

104. During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. For example, the recognition of an impairment loss may indicate that the amortization period needs to be changed.

105. Over time, the pattern of future economic benefits or service potential expected to flow to an entity from an intangible asset may change. For example, it may become apparent that a diminishing balance method of amortization is appropriate rather than a straight-line method. Another example is if use of the rights represented by a license is deferred pending action on other components of the entity's strategic plan. In this case, economic benefits or service potential that flow from the asset may not be received until later periods.

Intangible Assets with Indefinite Useful Lives

106. **An intangible asset with an indefinite useful life shall not be amortized.**

107. In accordance with IPSAS 21 and IPSAS 26, an entity is required to test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment by comparing its recoverable service amount or its recoverable amount, as appropriate, with its carrying amount:

(a) Annually; and

(b) Whenever there is an indication that the intangible asset may be impaired.

Review of Useful Life Assessment

108. **The useful life of an intangible asset that is not being amortized shall be reviewed each reporting period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite shall be accounted for as a change in an accounting estimate in accordance with IPSAS 3.**

109. In accordance with either IPSAS 21 or IPSAS 26, as appropriate, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired. As a result, the entity tests the asset for impairment by comparing its recoverable service amount or its recoverable amount, determined in accordance with either IPSAS 21 or IPSAS 26, as appropriate, with its carrying amount, and recognizing any excess of the carrying amount over the recoverable service amount or recoverable amount as appropriate, as an impairment loss.

Recoverability of the Carrying Amount—Impairment Losses

110. To determine whether an intangible asset is impaired, an entity applies either IPSAS 21 or IPSAS 26, as appropriate. Those Standards explain when and how an entity reviews the carrying amount of its assets, how it determines the recoverable service amount or recoverable amount of an asset, as appropriate, and when it recognizes or reverses an impairment loss.

Retirements and Disposals

111. **An intangible asset shall be derecognized:**

(a) **On disposal (including disposal through a non-exchange transaction); or**

(b) **When no future economic benefits or service potential are expected from its use or disposal.**

112. **The gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be recognized in surplus or deficit when the asset is derecognized (unless IPSAS 43 requires otherwise on a sale and leaseback).**

113. The disposal of an intangible asset may occur in a variety of ways (e.g., by sale, by entering into a finance lease, or through a non-exchange transaction). In determining the date of disposal of such an asset, an entity applies the criteria in IPSAS 9, *Revenue from Exchange Transactions* for recognizing revenue from the sale of goods. IPSAS 43 applies to disposal by a sale and leaseback.

114. If, in accordance with the recognition principle in paragraph 28, an entity recognizes in the carrying amount of an asset the cost of a replacement for part of an intangible asset, then it derecognizes the carrying amount of the replaced part. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or internally generated.

114A. In the case of:

(a) A license or similar right previously granted by one combining operation to another combining operation that is recognized by the resulting entity in an amalgamation; or

(b) A reacquired right recognized as an intangible asset in an acquisition,

if the right is subsequently reissued (sold) to a third party, the related carrying amount, if any, shall be used in determining the gain or loss on reissue.

115. The consideration receivable on disposal of an intangible asset is recognized initially at its fair value. If payment for the intangible asset is deferred, the consideration received is recognized initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognized as interest revenue in accordance with IPSAS 9 reflecting the effective yield on the receivable.

116. Amortization of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used, unless the asset has been fully depreciated.

Disclosure

General

117. **An entity shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:**

(a) **Whether the useful lives are indefinite or finite and, if finite, the useful lives or the amortization rates used;**

(b) **The amortization methods used for intangible assets with finite useful lives;**

(c) **The gross carrying amount and any accumulated amortization (aggregated with accumulated impairment losses) at the beginning and end of the period;**

(d) **The line item(s) of the statement of financial performance in which any amortization of intangible assets is included;**

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

(i) **Additions, indicating separately those from internal development, those acquired separately, and those acquired through acquisitions;**

(ii) **Disposals;**

(iii) **Increases or decreases during the period resulting from revaluations under paragraphs 74, 84 and 85 (if any);**

(iv) **Impairment losses recognized in surplus or deficit during the period in accordance with IPSAS 21 or IPSAS 26 (if any);**

(v) **Impairment losses reversed in surplus or deficit during the period in accordance with IPSAS 21 or IPSAS 26 (if any);**

(vi) **Any amortization recognized during the period;**

(vii) **Net exchange differences arising on the translation of the financial statements into the presentation currency, and on the translation of a foreign operation into the presentation currency of the entity; and**

(viii) **Other changes in the carrying amount during the period.**

118. A class of intangible assets is a grouping of assets of a similar nature and use in an entity's operations. Examples of separate classes may include:

(a) Brand names;

(b) Mastheads and publishing titles;

(c) Computer software;

(d) Licenses;

(e) Copyrights, patents, and other industrial property rights, service, and operating rights;

(f) Recipes, formulae, models, designs, and prototypes; and

(g) Intangible assets under development.

The classes mentioned above are disaggregated (aggregated) into smaller (larger) classes if this results in more relevant information for the users of the financial statements.

119. An entity discloses information on impaired intangible assets in accordance with IPSAS 21 or IPSAS 26 in addition to the information required by paragraph 117(e)(iii)–(v).

120. IPSAS 3 requires an entity to disclose the nature and amount of a change in an accounting estimate that has a material effect in the current period or is expected to have a material effect in subsequent periods. Such disclosure may arise from changes in:

(a) The assessment of an intangible asset's useful life;

(b) The amortization method; or

(c) Residual values.

121. **An entity shall also disclose:**

(a) **For an intangible asset assessed as having an indefinite useful life, the carrying amount of that asset and the reasons supporting the assessment of an indefinite useful life. In giving these reasons, the entity shall describe the factor(s) that played a significant role in determining that the asset has an indefinite useful life.**

(b) **A description, the carrying amount, and remaining amortization period of any individual intangible asset that is material to the entity's financial statements.**

(c) **For intangible assets acquired through a non-exchange transaction and initially recognized at fair value (see paragraphs 42–43):**

(i) **The fair value initially recognized for these assets;**

(ii) **Their carrying amount; and**

(iii) **Whether they are measured after recognition under the cost model or the revaluation model.**

(d) **The existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities.**

(e) **The amount of contractual commitments for the acquisition of intangible assets.**

122. When an entity describes the factor(s) that played a significant role in determining that the useful life of an intangible asset is indefinite, the entity considers the list of factors in paragraph 89.

Intangible Assets Measured after Recognition using the Revaluation Model

123. **If intangible assets are accounted for at revalued amounts, an entity shall disclose the following:**

(a) **By class of intangible assets:**

(i) **The effective date of the revaluation;**

(ii) **The carrying amount of revalued intangible assets; and**

(iii) **The carrying amount that would have been recognized had the revalued class of intangible assets been measured after recognition using the cost model in paragraph 73;**

(b) **The amount of the revaluation surplus that relates to intangible assets at the beginning and end of the reporting period, indicating the changes during the reporting period and any restrictions on the distribution of the balance to owners; and**

(c) **The methods and significant assumptions applied in estimating the assets' fair values.**

124. It may be necessary to aggregate the classes of revalued assets into larger classes for disclosure purposes. However, classes are not aggregated if this would result in the combination of a class of intangible assets that includes amounts measured under both the cost and revaluation models.

Research and Development Expenditure

125. **An entity shall disclose the aggregate amount of research and development expenditure recognized as an expense during the period.**

126. Research and development expenditure comprises all expenditure that is directly attributable to research or development activities (see paragraphs 64 and 65 for guidance on the type of expenditure to be included for the purpose of the disclosure requirement in paragraph 125).

Other Information

127. An entity is encouraged, but not required, to disclose the following information:

(a) A description of any fully amortized intangible asset that is still in use; and

(b) A brief description of significant intangible assets controlled by the entity but not recognized as assets because they did not meet the recognition criteria in this Standard.

Transitional Provisions

128. **An entity that has previously recognized intangible assets shall apply this Standard retrospectively in accordance with IPSAS 3.**

129. [Deleted]

130. [Deleted]

131. [Deleted]

131A. Paragraph 79 was amended by *Improvements to IPSASs 2014* issued in January 2015. An entity shall apply that amendment to all revaluations recognized in annual periods beginning on or after the date of initial application of that amendment and in the immediately preceding annual period.

Effective Date

132. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after April 1, 2011. Earlier application is encouraged. If an entity applies this Standard for a period beginning before April 1, 2011, it shall disclose that fact and apply IPSAS 21 and IPSAS 26 at the same time.**

132A. **Paragraph 6 was amended by IPSAS 32, *Service Concession Arrangements: Grantor* issued in October 2011. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2014, it shall disclose that fact and at the same time apply IPSAS 32, the amendments to paragraphs 6 and 42A of IPSAS 5, the amendments to paragraphs 25–27 and 85B of IPSAS 13, the amendments to paragraphs 5, 7 and 107C of IPSAS 17 and the amendments to paragraphs 2 and 125A of IPSAS 29.**

132B. **Paragraphs 79, 91 and 97 were amended and paragraphs 97A, 97B, 97C and 131A added by *Improvements to IPSASs 2014* issued in January 2015. An entity shall apply those amendments prospectively for annual financial statements covering periods beginning on or after January 1, 2015. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2015, it shall disclose that fact.**

132C. **Paragraphs 129, 130, 131 and 133 were amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

132D. **IPSAS 35, *Consolidated Financial Statements* and IPSAS 37, *Joint Arrangements* issued in January 2015, amended paragraph 6(d). An entity shall apply that amendment when it applies IPSAS 35 and IPSAS 37.**

132E. **Paragraphs 3, 96, 116 and 117 were amended by *Improvements to IPSASs 2015*, issued in April 2016. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2017, it shall disclose that fact.**

132F. **Paragraphs 4 and 5 were deleted by *The Applicability of IPSASs*, issued in April 2016. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2018, it shall disclose that fact.**

132G. ***Impairment of Revalued Assets* (Amendments to IPSASs 21 and 26) amended paragraph 110. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies that amendment for a period beginning before January 1, 2018, it shall disclose that fact.**

132H. **Paragraphs 6, 35 and 64 were amended by IPSAS 39, *Employee Benefits,* issued in July 2016. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2018 it shall disclose that fact and apply IPSAS 39 at the same time.**

132I. **Paragraphs 3, 6, 18, 24, 40, 41, 66, 67, and 117 were amended and paragraphs 18A, 26A, 39A–39E, 93A and 114A were added by IPSAS 40, *Public Sector Combinations,* issued in January 2017. An entity shall apply these amendments prospectively for annual financial statements covering periods beginning on or after January 1, 2019. Therefore, amounts recognized for intangible assets and goodwill in prior public sector combinations shall not be adjusted. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2019 it shall disclose that fact and apply IPSAS 40 at the same time.**

132J. **Paragraph 109 was amended by *Improvements to IPSAS, 2018*, issued in October 2018. An entity shall apply this amendment prospectively for annual financial statements covering periods beginning on or after January 1, 2019. Earlier application is permitted. If an entity applies this amendment for a period beginning before January 1, 2019, it shall disclose that fact and at the same time apply *Impairment of Revalued Assets* (Amendments to IPSAS 21, *Impairment of Non-Cash-Generating Assets*, and IPSAS 26, *Impairment of Cash-Generating Assets*).**

132K. **Paragraphs 6, 9, 112, 113 and AG6 were amended by IPSAS 43 issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.**

133. When an entity adopts the accrual basis IPSASs of accounting as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards* (*IPSASs)* for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 31.

Website Costs

AG1. An entity may incur internal expenditure on the development and operation of its own website for internal or external access. A website designed for external access may be used for various purposes such as to disseminate information, create awareness of services, request comment on draft legislation, promote and advertise an entity's own services and products, provide electronic services, and sell services and products. A website designed for internal access may be used to store entity policies and details of users of a service, and search relevant information.

AG2. The stages of a website's development can be described as follows:

(a) Planning—includes undertaking feasibility studies, defining objectives and specifications, evaluating alternatives, and selecting preferences;

(b) Application and Infrastructure Development—includes obtaining a domain name, purchasing and developing hardware and operating software, installing developed applications, and stress testing;

(c) Graphical Design Development—includes designing the appearance of web pages; and

(d) Content Development—includes creating, purchasing, preparing, and uploading information, either textual or graphical in nature, on the website before the completion of the website's development. This information may either be stored in separate databases that are integrated into (or accessed from) the website or coded directly into the web pages.

AG3. Once development of a website has been completed, the Operating stage begins. During this stage, an entity maintains and enhances the applications, infrastructure, graphical design, and content of the website.

AG4. When accounting for internal expenditure on the development and operation of an entity's own website for internal or external access, the issues are:

(a) Whether the website is an internally generated intangible asset that is subject to the requirements of this Standard; and

(b) The appropriate accounting treatment of such expenditure.

AG5. This Application Guidance does not apply to expenditure on purchasing, developing, and operating hardware (e.g., web servers, staging servers, production servers, and Internet connections) of a website. Such expenditure is accounted for under IPSAS 17. Additionally, when an entity incurs expenditure on an Internet service provider hosting the entity's website, the expenditure is recognized as an expense when the services are received.

AG6. IPSAS 31 does not apply to intangible assets held by an entity for sale in the ordinary course of operations (see IPSAS 11 and IPSAS 12) or leases of intangible assets accounted for in accordance with IPSAS 43. Accordingly, this Application Guidance does not apply to expenditure on the development or operation of a website (or website software) for sale to another entity or that is accounted for in accordance with IPSAS 43.

AG7. An entity's own website that arises from development and is for internal or external access is an internally generated intangible asset that is subject to the requirements of this Standard.

AG8. A website arising from development is recognized as an intangible asset if, and only if, in addition to complying with the general requirements described in paragraph 28 of this Standard for recognition and initial measurement, an entity can satisfy the requirements in paragraph 55 of this Standard. In particular, an entity may be able to satisfy the requirement to demonstrate how its website will generate probable future economic benefits or service potential in accordance with paragraph 55(d) of this Standard when, for example, the website is capable of generating revenues, including direct revenues from enabling orders to be placed, or providing services using the website, rather than at a physical location using civil servants. An entity is not able to demonstrate how a website developed solely or primarily for promoting and advertising its own services and products will generate probable future economic benefits or service potential, and consequently all expenditure on developing such a website is recognized as an expense when incurred.

AG9. Any internal expenditure on the development and operation of an entity's own website is accounted for in accordance with this Standard. The nature of each activity for which expenditure is incurred (e.g., training employees and maintaining the website) and the website's stage of development or post-development are evaluated to determine the appropriate accounting treatment (additional guidance is provided in the table included at the end of the Illustrative Examples). For example:

(a) The Planning stage is similar in nature to the research phase in paragraphs 52–54 of this Standard. Expenditure incurred in this stage is recognized as an expense when it is incurred;

(b) The Application and Infrastructure Development stage, the Graphical Design stage, and the Content Development stage, to the extent that content is developed for purposes other than to advertise and promote an entity's own services and products, are similar in nature to the development phase in paragraphs 55–62 of this Standard. Expenditure incurred in these stages is included in the cost of a website recognized as an intangible asset in accordance with paragraph AG8 when the expenditure can be directly attributed and is necessary to creating, producing or preparing the website for it to be capable of operating in the manner intended by management. For example, expenditure on purchasing or creating content (other than content that advertises and promotes an entity's own services and products) specifically for a website, or expenditure to enable use of the content (e.g., a fee for acquiring a license to reproduce) on the website, is included in the cost of development when this condition is met. However, in accordance with paragraph 83 of this Standard, expenditure on an intangible item that was initially recognized as an expense in previous financial statements is not recognized as part of the cost of an intangible asset at a later date (e.g., if the costs of a copyright have been fully amortized, and the content is subsequently provided on a website);

(c) Expenditure incurred in the Content Development stage, to the extent that content is developed to advertise and promote an entity's own services and products (e.g., digital photographs of products), is recognized as an expense when incurred in accordance with paragraph 67(c) of this Standard. For example, when accounting for expenditure on professional services for taking digital photographs of an entity's own products and for enhancing their display, expenditure is recognized as an expense as the professional services are received during the process, not when the digital photographs are displayed on the website; and

(d) The Operating stage begins once development of a website is complete. Expenditure incurred in this stage is recognized as an expense when it is incurred unless it meets the recognition criteria in paragraph 28 of this Standard.

AG10. A website that is recognized as an intangible asset under paragraph AG8 of this Application Guidance is measured after initial recognition by applying the requirements of paragraphs 71–86 of this Standard. The best estimate of a website's useful life should be short, as described in paragraph 91.

AG11. The guidance in paragraphs AG1–AG10 does not specifically apply to software development costs. However, an entity may apply the principles in these paragraphs.

Appendix B

Amendments to Other IPSASs

[Deleted]

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 31.

Background

BC1. The IPSASB's IFRSs Convergence Program is an important element in IPSASB's work program. The IPSASB's policy is to converge accrual basis IPSASs with IFRSs issued by the IASB where appropriate for public sector entities.

BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the *Comparison with IFRS* included in each IPSAS. The Comparison with IAS 38 references the December 31, 2008 version of IAS 38.

Scope

BC3. The Board considered whether powers and rights conferred by legislation, a constitution, or by equivalent means should be included in the scope of the Standard. The Board has not formed a view on this topic and therefore, these powers and rights are excluded from the scope of this Standard. The Board is currently developing a Conceptual Framework and will reconsider, if necessary, the applicability of this Standard to powers and rights conferred by legislation, a constitution, or by equivalent means.

BC4. IAS 38 contains requirements and guidance on goodwill and intangible assets acquired in a business combination. In issuing IPSAS 31, the IPSASB considered whether goodwill and intangible assets acquired in a business combination should be included in the scope of this Standard. The IPSASB had not yet issued an IPSAS dealing with business combinations and considered it likely that a number of public sector specific issues will arise when combinations of public sector entities take place. The IPSASB concluded at that time that goodwill and intangible assets acquired in a business combination should not be included in the scope of this Standard. In accordance with the hierarchy in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, users were referred to the requirements of the relevant international or national accounting standards dealing with goodwill and intangible assets acquired in a business combination.

BC4A. Subsequently, the IPSASB issued IPSAS 40, *Public Sector Combinations*. IPSAS 40 specifies the accounting for public sector combinations, including the initial recognition and measurement of intangible assets. IPSAS 40 does not specify the subsequent measurement and disclosure of intangible assets recognized as part of a public sector combination. Consequently, the IPSASB reconsidered whether goodwill and intangible assets recognized in a public sector combination should be included in the scope of this Standard. The IPSASB agreed that such assets should be included in the scope of this Standard as a result of the IPSASB issuing IPSAS 40, and amended the Standard accordingly.

BC5. IAS 38 contains requirements on exchanges of assets when the exchange transaction lacks commercial substance. The IPSASB considered whether this guidance is necessary and concluded that it was not necessary because this issue is addressed in IPSAS 23.

BC6. The IASB has issued an Interpretation of IAS 38 dealing with accounting for website costs. The IPSASB believes the guidance contained in SIC 32 is relevant to the public sector. Accordingly, IPSAS 31 includes as application guidance the definitions and guidance contained in SIC 32. This application guidance is an integral part of IPSAS 31. The appendix in SIC 32 that illustrates the relevant accounting principles and how they are linked to IPSAS 31 is included in the illustrative examples.

BC7. The Standard does not address emissions trading schemes. The IPSASB noted that, emissions trading schemes a government has established are a type of powers and rights conferred by legislation, a constitution, or by equivalent means, which are excluded from the scope of the Standard (see paragraph BC3). A government may acquire permits under emissions trading schemes. v treatment of such permits is currently being studied by some international and national standard-setting bodies and a consensus has not been reached on the appropriate accounting treatment. The IPSASB will reconsider, if necessary, the applicability of this Standard to emissions trading schemes.

Intangible Assets Acquired through a Non-Exchange Transaction

BC8. IPSAS 23 prescribes the initial recognition, initial measurement and disclosure of assets and liabilities arising from non-exchange revenue transactions. This Standard addresses the circumstance where an intangible asset is acquired through a non-exchange transaction. The IPSASB agreed that, for intangible assets arising from such transactions, an entity applies the requirements of IPSAS 23 in conjunction with this Standard for initial measurement of the intangible asset and, accordingly, considers directly attributable costs specified in this Standard.

Revaluation Model

BC9. The revaluation model proposed in IPSAS 31 is similar to that in IAS 38 which requires revaluations to be accounted for on an asset-by-asset basis. IPSAS 17, *Property, Plant, and Equipment* requires revaluations to be accounted for by class of assets rather than by individual asset. The IPSASB considered this approach for intangible assets, but concluded that it was not necessary because intangible assets differ from property, plant, and equipment in that they are less likely to be homogeneous. One of the major types of intangible assets of public sector entities is internally-developed software, for which detailed information is available on an individual asset basis. Consequently, the IPSASB concluded that it was appropriate to require revalued intangible assets to be accounted for on an asset-by-asset basis.

Revision of IPSAS 31 as a result of IASB's *Improvements to IFRSs* and *Narrow Scope Amendments* issued in December 2013 and May 2014

BC10. The IPSASB reviewed the revisions to IAS 38 included in the *Improvements to IFRSs* and *Clarification of Acceptable Methods of Depreciation and Amortisation* issued by the IASB in December 2013 and May 2014 and generally concurred that there was no public sector specific reason for not adopting the amendments.

Revision of IPSAS 31 as a result of Part II of *Improvements to IPSASs 2015*: issues raised by stakeholders

BC11. Stakeholders indicated that IPSASs referred to non-current assets held for sale and disposal groups inconsistently. The IPSASB concluded that IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, may only be appropriate for the public sector in certain circumstances, for the following reasons:

(a) Sales of assets in the public sector may not be completed within one year because of the levels of approval required. This raises questions about the relevance and consistency of information provided in accordance with IFRS 5. In particular, the IPSASB notes that, under IFRS 5, non-current assets held for sale are not depreciated. The IPSASB has concerns that not depreciating assets for an extended period of time may be inappropriate.

(b) Many assets in the public sector are disposed of through a transfer or distribution for no or nominal consideration. As IFRS 5 deals with sales at fair value, the measurement and disclosure requirements may not provide relevant information for these transfers. However, the IPSASB recognizes that the measurement and disclosure requirements in IFRS 5 may be appropriate where sales are intended to take place at fair value.

(c) Many discontinued operations in the public sector are operations that previously provided services at no or nominal cost. As IFRS 5 deals with discontinued operations that were either cash-generating units or a group of cash-generating units prior to disposal or being classified as held for sale, the disclosure requirements may not provide relevant information for public sector discontinued operations. However, the IPSASB recognizes that the disclosure requirements in IFRS 5 may be appropriate where discontinued operations were previously either cash-generating units or one or more groups of cash generating units.

Because the IPSASB had concluded that IFRS 5 would only be appropriate in the public sector in limited circumstances, the IPSASB agreed to remove references in IPSAS to international or national accounting standards dealing with non-current assets held for sale and discontinued operations. The IPSASB had concerns that retaining this reference may result in entities following the requirements of IFRS 5 in circumstances where this may not be appropriate. The IPSASB noted that IPSAS 3 provides guidance on selecting accounting policies for transactions that are not specifically addressed in IPSASs. This guidance would permit entities to adopt an accounting policy that is consistent with IFRS 5 where the entity considers this is appropriate.

Revision of IPSAS 31 as a result of the IPSASB's *The Applicability of IPSASs*, issued in April 2016

BC12. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:

(a) Removes the standard paragraphs about the applicability of IPSASs to "public sector entities other than GBEs" from the scope section of each Standard;

(b) Replaces the term "GBE" with the term "commercial public sector entities", where appropriate; and

(c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.

Revision of IPSAS 31 as a result of *Improvements to IPSAS, 2018*

BC13. Paragraph 109 requires an entity to test an intangible asset for impairment when reassessing its useful life. When this standard was issued, such a test was only required for intangible assets measured under the cost model. Following the publication of *Impairment of Revalued Assets* (Amendments to IPSAS 21, *Impairment of Non-Cash-Generating Assets*, and IPSAS 26, *Impairment of Cash-Generating Assets*) in July 2016, this test is required for all intangible assets, and paragraph 109 has been amended accordingly.

ILLUSTRATIVE EXAMPLES

CONTENTS

Illustrative Examples

These examples accompany, but are not part of, IPSAS 31.

Recognition and Measurement of an Internally-Generated Intangible Asset

Example Applying Paragraph 63 of this Standard

IE1. An entity developed a new system to schedule court cases more effectively that will result in increased service delivery. During the financial year ending March 31, 20X8, expenditure incurred for the development of the system was CU1,000,[1] of which CU900 was incurred before March 1, 20X8 and CU100 was incurred between March 1, 20X8 and March 31, 20X8. The entity is able to demonstrate that, at March 1, 20X8, the newly developed system met the criteria for recognition as an intangible asset. The recoverable service amount of the system (including future cash outflows to complete the development before it is available for use) is estimated to be CU500.

IE2. At the end of the financial year, the developed system is recognized as an intangible asset at a cost of CU100 (expenditure incurred since the date when the recognition criteria were met, i.e., March 1, 20X8). The CU900 expenditure incurred before March 1, 20X8 is recognized as an expense because the recognition criteria were not met until March **1,** 20X8. This expenditure does not form part of the cost of the system recognized in the statement of financial position.

IE3. During the financial year ending March 31, 20X9, expenditure incurred is CU2,000. At the end of this financial year, the recoverable service amount of the system (including future cash outflows to complete the system before it is available for use) is estimated to be CU1,900.

IE4. As at March 31, 20X9, the cost of the developed system is CU2,100 (CU100 expenditure recognized at the end of 20X8 plus CU2,000 expenditure recognized in the 20X9 financial year). The entity recognizes an impairment loss of CU200 to adjust the carrying amount of the developed system before the impairment loss (CU2,100) to its recoverable service amount (CU1,900). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in IPSAS 21 are met.

Example Applying Paragraphs 55–65 of this Standard

IE5. An entity is developing a system which produces statistical reports for its internal use and for sale to third-parties. The system is technically feasible, the entity is aware that there is a demand for this type of report and which third-parties are willing to pay for the product and therefore will generate probable future economic benefits. The expenditure attributable to the development of this system can be identified and measured reliably.

Assessing the Useful Lives of Intangible Assets

IE6. The following guidance provides examples on determining the useful life of an intangible asset in accordance with this Standard.

IE7. Each of the following examples describes an acquired intangible asset, the facts and circumstances surrounding the determination of its useful life, and the subsequent accounting based on that determination.

An Acquired Patent with a Finite Useful Life

IE8. Entity A acquires a patent over a formula for a vaccine, from Entity B to secure Entity A's ability to provide free vaccinations to its constituents. The vaccine protected by the patent is expected to be a source of service potential for at least 15 years. Entity A has a commitment from Entity C to purchase that patent in five years for 60 per cent of the fair value of the patent at the date it was acquired, and Entity A intends to sell the patent in five years.

IE9. The patent would be amortized over its five-year useful life to Entity A, with a residual value equal to 60 per cent of the patent's fair value at the date it was acquired. The patent would also be reviewed for impairment in accordance with IPSAS 21.

An Acquired Patent with an Indefinite Useful Life

IE10. Entity A acquires an asset, the patent over a formula for a vaccine, from Entity B to secure Entity A's ability to provide free vaccinations to its constituents. It is expected that the formula will need to be slightly modified every 10 years to maintain its efficacy. There is evidence to support ongoing renewal of the patent. A contract with Entity B stipulates that Entity B will maintain the efficacy of the formula continuously, and evidence supports its ability to do so. The costs to renew the patent and maintain the efficacy of the formula are expected to be insignificant and will be paid to the Entity B when the improvements are made.

[1] In this Standard, monetary amounts are denominated in "currency units" (CU).

IE11. An analysis of product lifecycle studies, and demographic and environmental trends, provides evidence that the patent will provide service potential to Entity A by enabling it to deliver its vaccination program for an indefinite period. Accordingly, the patent would be treated as having an indefinite useful life. Therefore, the patent would not be amortized unless its useful life is determined to be finite. The patent would be tested for impairment in accordance with IPSAS 21.

An Acquired Copyright that has a Remaining Legal Life of 50 Years

IE12. Entity A acquires a copyright from Entity B to enable it to reproduce and sell the copyrighted material on a cost-recovery basis to its constituency. An analysis of the habits of the entity's constituency and other trends provides evidence that the copyrighted material will generate net cash inflows for only 30 more years.

IE13. The copyright would be amortized over its 30-year estimated useful life. The copyright also would be reviewed for impairment in accordance with IPSAS 21.

An Acquired Broadcasting License that Expires in Five Years—Part A

IE14. Entity A acquires a broadcasting license from Entity B. Entity A intends to provide free broadcasting services in the community. The broadcasting license is renewable every 10 years if Entity A provides at least an average level of service to its users of its service and complies with the relevant legislative requirements. The license may be renewed indefinitely at little cost and has been renewed twice before the most recent acquisition. Entity A intends to renew the license indefinitely and evidence supports its ability to do so. Historically, there has been no compelling challenge to the license renewal. The technology used in broadcasting is not expected to be replaced by another technology at any time in the foreseeable future. Therefore, the license is expected to contribute to Entity A's ability to provide free broadcasting services indefinitely.

IE15. Entity B does not recognize its power to grant broadcasting licenses as an intangible asset. The broadcasting license would be treated by Entity A as having an indefinite useful life because it is expected to contribute to the entity's ability to provide free broadcasting services indefinitely. Therefore, the license would not be amortized until its useful life is determined to be finite. The license would be tested for impairment in accordance with IPSAS 21.

An Acquired Broadcasting License that Expires in Five Years—Part B

IE16. The licensing authority subsequently decides that it will no longer renew broadcasting licenses, but rather will auction the licenses. At the time the licensing authority's decision is made, Entity A's broadcasting license has three years until it expires. Entity A expects that the license will continue to provide service potential until the license expires.

IE17. Because the broadcasting license can no longer be renewed, its useful life is no longer indefinite. Thus, the acquired license would be amortized by Entity A over its remaining three-year useful life and immediately tested for impairment in accordance with IPSAS 21.

An Acquired Right to Operate a Public Transit Route Between Two Cities that Expires in Three Years

IE18. Entity A acquires from Entity B a right to operate a public transit route between two cities, which generates revenues. The transit route may be renewed every five years, and Entity A intends to comply with the applicable rules and regulations surrounding renewal. Transit route renewals are routinely granted at a minimal cost and historically have been renewed when the entity that holds the rights to the route has complied with the applicable rules and regulations. Entity A expects to provide transit services on the route indefinitely. An analysis of demand and cash flows supports those assumptions.

IE19. Because the facts and circumstances support the public transit route providing cash flows to Entity A for an indefinite period of time, the intangible asset related to the transit route is treated as having an indefinite useful life. Therefore, the intangible asset would not be amortized until its useful life is determined to be finite. It would be tested for impairment in accordance with IPSAS 26 annually and whenever there is an indication that it may be impaired.

An Acquired List of Property Owners

IE20. A local authority (Entity A) acquires a list of property owners from another public sector entity which is responsible for registering property deeds (Entity B). Entity B is at another level of government, and is not part of Entity A's reporting entity. Entity A intends to use the list to generate tax revenues and Entity A expects that it will be able to derive benefit from the information on the acquired list[2] for at least one year, but no more than three years.

[2] Although the local authority may intend to add property owners and other information to the database in the future, the expected benefits of the acquired database relate only to the property owners on that database at the date it was acquired. Subsequent additions would be considered to be internally-developed intangible assets, and accounted for in accordance with this Standard.

IE21. The list of property owners would be amortized over Entity A's best estimate of its useful life, say 18 months. Although Entity B may intend to add property owner names and other information to the list in the future, the expected benefits to Entity A of the acquired list relate only to the property owners on that list at the date Entity A acquired the list. The list of property owners also would be reviewed for impairment in accordance with IPSAS 21 by assessing annually and whenever there is any indication that it may be impaired.

Examples Illustrating the Application Guidance

IE22. The purpose of the table is to illustrate examples of expenditure that occur during each of the stages described in paragraphs AG2–AG3 and to illustrate application of paragraphs AG4–AG11 to assist in clarifying their meaning. It is not intended to be a comprehensive checklist of expenditure that might be incurred.

STAGE/NATURE OF EXPENDITURE	ACCOUNTING TREATMENT
Planning	
• Undertaking feasibility studies; • Defining hardware and software specifications; • Evaluating alternative products and suppliers; and • Selecting preferences.	Recognize as an expense when incurred in accordance with paragraph 52 of this Standard.
Application and Infrastructure Development	
• Purchasing or developing hardware. • Obtaining a domain name; • Developing operating software (e.g., operating system and server software); • Developing code for the application; • Installing developed applications on the web server; and • Stress testing.	Apply the requirements of IPSAS 17. Recognize as an expense when incurred, unless the expenditure can be directly attributed to preparing the website to operate in the manner intended by management, and the website meets the recognition criteria in paragraphs 28 and 55[4] of this Standard.
Graphical Design Development	
• Designing the appearance (e.g., layout and color) of web pages.	Recognize as an expense when incurred, unless the expenditure can be directly attributed to preparing the website to operate in the manner intended by management, and the website meets the recognition criteria in paragraphs 28 and 55[5] of this Standard.
Content Development	
• Creating, purchasing, preparing (e.g., creating links and identifying tags), and uploading information, either textual or graphic in nature, on the website before the completion of the website's development. Examples of content include information about an entity, services, or products, and topics that subscribers access.	Recognize as an expense when incurred in accordance with paragraph 67(c) of this Standard to the extent that content is developed to advertise and promote an entity's own services and products (e.g., digital photographs of products). Otherwise, recognize as an expense when incurred, unless the expenditure can be directly attributed to preparing the website to operate in the manner intended by management, and the website meets the recognition criteria in paragraphs 28 and 55[6] of this Standard.
Operating	
• Updating graphics and revising content; • Adding new functions, features, and content; • Registering the website with search engines; • Backing up data; • Reviewing security access; and • Analyzing usage of the website.	Assess whether it meets the definition of an intangible asset and the recognition criteria set out in paragraph 28 of this Standard, in which case the expenditure is recognized in the carrying amount of the website asset.

[4] All expenditure on developing a website solely or primarily for promoting, advertising, or providing information to the public at large regarding the entity's own products and services is recognized an expense when incurred in accordance with paragraph 66 of this Standard.

[5] See footnote 4.

[6] See footnote 4.

STAGE/NATURE OF EXPENDITURE	ACCOUNTING TREATMENT
Other	
• Selling, administrative, and other general overhead expenditure unless it can be directly attributed to preparing the website for use to operate in the manner intended by management; • Clearly identified inefficiencies and initial operating deficits incurred before the website achieves planned performance (e.g., false-start testing); and • Training employees to operate the website.	Recognize as an expense when incurred in accordance with paragraphs 63–69 of this Standard.

Comparison with IAS 38

IPSAS 31, *Intangible Assets* is drawn primarily from IAS 38, *Intangible Assets* (as at December 31, 2008). The main differences between IPSAS 31 and IAS 38 are as follows:

- IPSAS 31 includes a scope exclusion for the powers and rights conferred by legislation, a constitution, or by equivalent means.
- IPSAS 31 incorporates the guidance contained in the Standing Interpretation Committee's Interpretation 32, *Intangible Assets—Web Site Costs* as Application Guidance to illustrate the relevant accounting principles.
- IPSAS 31 does not require or prohibit the recognition of intangible heritage assets. An entity that recognizes intangible heritage assets is required to comply with the disclosure requirements of this Standard with respect to those intangible heritage assets that have been recognized and may, but is not required to, comply with other requirements of this Standard in respect of those intangible heritage assets. IAS 38 does not have similar guidance.
- IAS 38 contains guidance on intangible assets acquired by way of a government grant. Paragraphs 31 of IPSAS 31 modifies this guidance to refer to intangible assets acquired through non-exchange transactions. IPSAS 31 states that where an intangible asset is acquired through a non-exchange transaction, the cost is its fair value as at the date it is acquired.
- IAS 38 provides guidance on exchanges of assets when an exchange transaction lacks commercial substance. IPSAS 31 does not include this guidance.
- The examples included in IAS 38 have been modified to better address public sector circumstances.
- IPSAS 31 uses different terminology, in certain instances, from IAS 38. The most significant examples are the use of the terms "revenue," "statement of financial performance," "surplus or deficit," "future economic benefits or service potential," "accumulated surpluses or deficits," "operating/operation," "rights from binding arrangements (including rights from contracts or other legal rights)," and "net assets/equity" in IPSAS 31. The equivalent terms in IAS 38 are "income," "statement of comprehensive income," "profit or loss," "future economic benefits," "retained earnings," "business," "contractual or other legal rights," and "equity."

IPSAS 32—SERVICE CONCESSION ARRANGEMENTS: GRANTOR

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) sets out the accounting requirements of the grantor in a service concession arrangement. It is adapted from Interpretation 12 (IFRIC 12), *Service Concession Arrangements*, developed by the International Financial Reporting Interpretations Committee and published by the International Accounting Standards Board (IASB). IFRIC 12 sets out the accounting requirements of the operator in a service concession arrangement. This IPSAS also contains extracts from Interpretation 29 (SIC-29), *Service Concession Arrangements: Disclosures*, developed by the Standing Interpretations Committee and published by the IASB. Extracts from IFRIC 12 and SIC-29 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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IPSAS 32—SERVICE CONCESSION ARRANGEMENTS: GRANTOR

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 32, *Service Concession Arrangements: Grantor* was issued in October 2011.

Since then, IPSAS 32 has been amended by the following IPSASs:

- IPSAS 43, *Leases* (issued January 2022)
- *COVID-19: Deferral of Effective Dates* (issued November 2020)
- IPSAS 41, *Financial Instruments* (issued August 2018)
- *The Applicability of IPSASs* (issued April 2016)
- *Improvements to IPSASs 2015* (issued April 2016)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)

Table of Amended Paragraphs in IPSAS 32

Paragraph Affected	How Affected	Affected By
3	Deleted	The Applicability of IPSASs April 2016
4	Deleted	The Applicability of IPSASs April 2016
13	Amended	Improvements to IPSASs April 2016
20	Amended	IPSAS 41 August 2018
29	Amended	IPSAS 41 August 2018
32	Amended	Improvements to IPSASs April 2016
33	Amended	Improvements to IPSASs April 2016
35	Deleted	IPSAS 33 January 2015
35A	New	Improvements to IPSASs April 2016
35B	New	Improvements to IPSASs April 2016
36A	New	IPSAS 33 January 2015
36B	New	Improvements to IPSASs April 2016
36C	New	The Applicability of IPSASs April 2016
36D	Amended	COVID-19: Deferral of Effective Dates November 2020
36E	New	IPSAS 43 January 2022
37	Amended	IPSAS 33 January 2015
AG13	Amended	IPSAS 43 January 2022
AG17	Amended	IPSAS 43 January 2022
AG20	Amended	Improvements to IPSASs April 2016
AG35	Amended	Improvements to IPSASs April 2016
AG37	Amended	IPSAS 41 August 2018
AG45	Amended	IPSAS 41 August 2018

Paragraph Affected	How Affected	Affected By
AG52	Amended	IPSAS 41 August 2018
AG53	Amended	IPSAS 41 August 2018
AG68	Deleted	IPSAS 33 January 2015
AG69	Deleted	IPSAS 33 January 2015
AG70	Deleted	IPSAS 33 January 2015
AG71	Deleted	IPSAS 33 January 2015
AG72	Deleted	IPSAS 33 January 2015
AG73	Deleted	IPSAS 33 January 2015
IG2	Amended	IPSAS 41 August 2018 IPSAS 43 January 2022
IG4	Amended	IPSAS 43 January 2022

IPSAS 32—SERVICE CONCESSION ARRANGEMENTS: GRANTOR

CONTENTS

International Public Sector Accounting Standard 32, *Service Concession Arrangements: Grantor* is set out in paragraphs 1–37. All the paragraphs have equal authority. IPSAS 32 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting for service concession arrangements by the grantor, a public sector entity.

Scope (see paragraphs AG1–AG2)

2. **An entity[1] that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for service concession arrangements.**

3. [Deleted]

4. [Deleted]

5. Arrangements within the scope of this Standard involve the operator providing public services related to the service concession asset on behalf of the grantor.

6. Arrangements outside the scope of this Standard are those that do not involve the delivery of public services and arrangements that involve service and management components where the asset is not controlled by the grantor (e.g., outsourcing, service contracts, or privatization).

7. This Standard does not specify the accounting by operators (guidance on accounting for service concession arrangements by the operator can be found in the relevant international or national accounting standard dealing with service concession arrangements).

Definitions (see paragraphs AG3–AG4)

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

A <u>binding arrangement</u>, for the purposes of this Standard, describes contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract.

A <u>grantor</u>, for the purposes of this Standard, is the entity that grants the right to use the service concession asset to the operator.

An <u>operator</u>, for the purposes of this Standard, is the entity that uses the service concession asset to provide public services subject to the grantor's control of the asset.

A <u>service concession arrangement</u> is a binding arrangement between a grantor and an operator in which:

(a) **The operator uses the service concession asset to provide a public service on behalf of the grantor for a specified period of time; and**

(b) **The operator is compensated for its services over the period of the service concession arrangement.**

A <u>service concession asset</u> is an asset used to provide public services in a service concession arrangement that:

(a) **Is provided by the operator which:**

  (i) **The operator constructs, develops, or acquires from a third party; or**

  (ii) **Is an existing asset of the operator; or**

(b) **Is provided by the grantor which:**

  (i) **Is an existing asset of the grantor; or**

  (ii) **Is an upgrade to an existing asset of the grantor.**

Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.

Recognition and Measurement of a Service Concession Asset (see paragraphs AG5–AG35)

9. **The grantor shall recognize an asset provided by the operator and an upgrade to an existing asset of the grantor as a service concession asset if:**

[1] An entity for the purposes of this Standard is referred to as the grantor.

(a) **The grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and**

(b) **The grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the asset at the end of the term of the arrangement.**

10. **This Standard applies to an asset used in a service concession arrangement for its entire useful life (a "whole-of-life" asset) if the conditions in paragraph 9(a) are met.**

11. **The grantor shall initially measure the service concession asset recognized in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset) at its fair value, except as noted in paragraph 12.**

12. **Where an existing asset of the grantor meets the conditions specified in paragraph 9(a) and 9(b) (or paragraph 10 for a whole-of-life asset), the grantor shall reclassify the existing asset as a service concession asset. The reclassified service concession asset shall be accounted for in accordance with IPSAS 17, *Property, Plant, and Equipment* or IPSAS 31, *Intangible Assets*, as appropriate.**

13. **After initial recognition or reclassification, service concession assets shall be accounted for in accordance with IPSAS 17 or IPSAS 31, as appropriate.**

Recognition and Measurement of Liabilities (see paragraphs AG36–AG50)

14. **Where the grantor recognizes a service concession asset in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset), the grantor shall also recognize a liability. The grantor shall not recognize a liability when an existing asset of the grantor is reclassified as a service concession asset in accordance with paragraph 12, except in circumstances where additional consideration is provided by the operator, as noted in paragraph 15.**

15. **The liability recognized in accordance with paragraph 14 shall be initially measured at the same amount as the service concession asset measured in accordance with paragraph 11, adjusted by the amount of any other consideration (e.g., cash) from the grantor to the operator, or from the operator to the grantor.**

16. The nature of the liability recognized is based on the nature of the consideration exchanged between the grantor and the operator. The nature of the consideration given by the grantor to the operator is determined by reference to the terms of the binding arrangement and, when relevant, contract law.

17. In exchange for the service concession asset, the grantor may compensate the operator for the service concession asset by any combination of:

(a) Making payments to the operator (the "financial liability" model);

(b) Compensating the operator by other means (the "grant of a right to the operator" model) such as:

(i) Granting the operator the right to earn revenue from third-party users of the service concession asset; or

(ii) Granting the operator access to another revenue-generating asset for the operator's use (e.g., a private wing of a hospital where the remainder of the hospital is used by the grantor to treat public patients or a private parking facility adjacent to a public facility).

Financial Liability Model (see paragraphs AG37–AG46)

18. **Where the grantor has an unconditional obligation to pay cash or another financial asset to the operator for the construction, development, acquisition, or upgrade of a service concession asset, the grantor shall account for the liability recognized in accordance with paragraph 14 as a financial liability.**

19. The grantor has an unconditional obligation to pay cash if it has guaranteed to pay the operator:

(a) Specified or determinable amounts; or

(b) The shortfall, if any, between amounts received by the operator from users of the public service and any specified or determinable amounts referred to in paragraph 19(a), even if the payment is contingent on the operator ensuring that the service concession asset meets specified quality or efficiency requirements.

20. IPSAS 28, *Financial Instruments: Presentation*, IPSAS 30, *Financial Instruments: Disclosures* and the derecognition requirements in IPSAS 41, *Financial Instruments* apply to the financial liability recognized under paragraph 14, except where this Standard provides requirements and guidance.

21. **The grantor shall allocate the payments to the operator and account for them according to their substance as a reduction in the liability recognized in accordance with paragraph 14, a finance charge, and charges for services provided by the operator.**

22. **The finance charge and charges for services provided by the operator in a service concession arrangement determined in accordance with paragraph 21 shall be accounted for as expenses.**

23. **Where the asset and service components of a service concession arrangement are separately identifiable, the service components of payments from the grantor to the operator shall be allocated by reference to the relative fair values of the service concession asset and the services. Where the asset and service components are not separately identifiable, the service component of payments from the grantor to the operator is determined using estimation techniques.**

Grant of a Right to the Operator Model (see paragraphs AG47–AG49)

24. **Where the grantor does not have an unconditional obligation to pay cash or another financial asset to the operator for the construction, development, acquisition, or upgrade of a service concession asset, and grants the operator the right to earn revenue from third-party users or another revenue-generating asset, the grantor shall account for the liability recognized in accordance with paragraph 14 as the unearned portion of the revenue arising from the exchange of assets between the grantor and the operator.**

25. **The grantor shall recognize revenue and reduce the liability recognized in accordance with paragraph 24 according to the economic substance of the service concession arrangement.**

26. Where the grantor compensates the operator for the service concession asset and the provision of services by granting the operator the right to earn revenue from third-party users of the service concession asset or another revenue-generating asset, the exchange is regarded as a transaction that generates revenue. As the right granted to the operator is effective for the period of the service concession arrangement, the grantor does not recognize revenue from the exchange immediately. Instead, a liability is recognized for any portion of the revenue that is not yet earned. The revenue is recognized according to the economic substance of the service concession arrangement, and the liability is reduced as revenue is recognized.

Dividing the Arrangement (see paragraph AG50)

27. **If the grantor pays for the construction, development, acquisition, or upgrade of a service concession asset partly by incurring a financial liability and partly by the grant of a right to the operator, it is necessary to account separately for each part of the total liability recognized in accordance with paragraph 14. The amount initially recognized for the total liability shall be the same amount as that specified in paragraph 15.**

28. **The grantor shall account for each part of the liability referred to in paragraph 27 in accordance with paragraphs 18–26.**

Other Liabilities, Commitments, Contingent Liabilities and Contingent Assets (see paragraphs AG51–AG54)

29. **The grantor shall account for other liabilities, commitments, contingent liabilities, and contingent assets arising from a service concession arrangement in accordance with IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, IPSAS 28, IPSAS 30, and IPSAS 41.**

Other Revenues (see paragraphs AG55–AG64)

30. **The grantor shall account for revenues from a service concession arrangement, other than those specified in paragraphs 24–26, in accordance with IPSAS 9, *Revenue from Exchange Transactions*.**

Presentation and Disclosure (see paragraphs AG65–AG67)

31. **The grantor shall present information in accordance with IPSAS 1.**

32. **All aspects of a service concession arrangement shall be considered in determining the appropriate disclosures in the notes. A grantor shall disclose the following information in respect of service concession arrangements in each reporting period:**

    (a) **A description of the arrangement;**

    (b) **Significant terms of the arrangement that may affect the amount, timing, and certainty of future cash flows (e.g., the period of the concession, re-pricing dates, and the basis upon which re-pricing or re-negotiation is determined);**

(c) **The nature and extent (e.g., quantity, time period, or amount, as appropriate) of:**

(i) **Rights to use specified assets;**

(ii) **Rights to expect the operator to provide specified services in relation to the service concession arrangement;**

(iii) **The carrying amount of service concession assets recognized at the end of the reporting period, including existing assets of the grantor reclassified as service concession assets;**

(iv) **Rights to receive specified assets at the end of the service concession arrangement;**

(v) **Renewal and termination options;**

(vi) **Other rights and obligations (e.g., major overhaul of service concession assets); and**

(vii) **Obligations to provide the operator with access to service concession assets or other revenue-generating assets; and**

(d) **Changes in the arrangement occurring during the reporting period.**

33. The disclosures required in accordance with paragraph 32 are provided individually for each material service concession arrangement or in aggregate for service concession arrangements involving services of a similar nature (e.g., toll collections, telecommunications or water treatment services). This disclosure is in addition to the disclosures required in IPSAS 17 and/or IPSAS 31 by class of assets. Service concession assets within service concession arrangements of a similar nature that are reported in aggregate may form a subset of a class of assets disclosed in accordance with IPSAS 17 and/or IPSAS 31 or may be included in more than one class of assets disclosed in accordance with IPSAS 17 and/or IPSAS 31. For example, for the purposes of IPSAS 17 a toll bridge may be included in the same class as other bridges. For the purposes of this paragraph, the toll bridge may be included with service concession arrangements reported in aggregate as toll roads.

Transitional

34. **A grantor that has previously recognized service concession assets and related liabilities, revenues, and expenses shall apply this Standard retrospectively in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.**

35. [Deleted]

35A. Paragraphs 13, 32, 33 and AG35 were amended by *Improvements to IPSASs 2015* issued in April 2016. An entity that has previously applied IPSAS 32 shall reassess the classification of service concession assets in accordance with paragraph 13. The entity shall present service concession assets in the revised classification retrospectively in accordance with IPSAS 3.

35B. Where service concessions assets are reclassified in accordance with paragraph 35A, an entity shall account for the service concession assets as follows:

(a) If the service concession assets have previously been measured using the cost model, and the class of assets to which those service concession assets have been reclassified is measured using the cost model, the entity shall continue to apply the cost model. The entity shall carry forward the cost of the service concession assets, along with any accumulated depreciation or amortization and any accumulated impairment losses.

(b) If the service concession assets have previously been measured using the cost model, and the class of assets to which those service concession assets have been reclassified is measured using the revaluation model, the entity shall either:

(i) Revalue the service concession assets; or

(ii) Subject to the requirements in IPSAS 3 dealing with changes in accounting policies, retrospectively apply the cost model to the remaining assets in the class of asset to which those service concession assets have been reclassified. Where information regarding the cost of the assets is not available, the entity may use the carrying amount of the assets as the deemed cost.

(c) If the service concession assets have previously been measured using the revaluation model, and the class of assets to which those service concession assets have been reclassified is measured using the cost model, the entity shall either:

(i) Retrospectively apply the cost model to the service concession assets. Where information regarding the cost of the assets is not available, the entity may use the carrying amount of the service concession assets as the deemed cost; or

(ii) Subject to the requirements in IPSAS 3 dealing with changes in accounting policies, revalue the remaining assets in the class of asset to which those service concession assets have been reclassified.

(d) If the service concession assets have previously been measured using the revaluation model, and the class of assets to which those service concession assets have been reclassified is measured using the revaluation model, the entity shall adjust the revaluation surplus in respect of each class of asset. Where previous revaluation decreases have been recognized in respect of either a service concession asset or one or more assets in the class to which the service concession asset is transferred, the entity shall consider whether transfers between revaluation surplus and accumulated surpluses or deficits are required.

Effective Date

36. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2014, it shall disclose that fact and apply IPSAS 5, *Borrowing Costs*, IPSAS 13, *Leases*, IPSAS 17, IPSAS 29, and IPSAS 31 at the same time.**

36A. **Paragraphs 35 and 37 were amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

36B. **Paragraphs 13, 32, 33 and AG35 were amended and paragraphs 35A and 35B added by *Improvements to IPSASs 2015* issued in April 2016. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2017 it shall disclose that fact.**

36C. **Paragraphs 3 and 4 were deleted by *The Applicability of IPSASs*, issued in April 2016. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2018, it shall disclose that fact.**

36D. **Paragraphs 20, 29, AG37, AG45, AG52 and AG53 were amended by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply IPSAS 41 at the same time.**

36E. **Paragraphs AG13 and AG17 were amended by IPSAS 43, *Leases* issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.**

37. When an entity adopts the accrual basis IPSASs of accounting as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards* (*IPSASs)* for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 32.

Scope (see paragraphs 2–7)

AG1. This Standard is intended to "mirror" Interpretation 12 of the International Financial Reporting Interpretations Committee, *Service Concession Arrangements* (IFRIC 12), which sets out the accounting requirements for the private sector operator in a service concession arrangement. To do so, the scope, principles for recognition of an asset, and terminology are consistent with the applicable guidance in IFRIC 12. However, because this Standard deals with the accounting issues of the grantor, this Standard addresses the issues identified in IFRIC 12 from the grantor's point of view, as follows:

(a) The grantor recognizes a financial liability when it is obliged to make a series of payments to the operator for provision of a service concession asset (i.e., constructed, developed, acquired, or upgraded). Using the measurement requirements specified in this Standard under paragraphs 12, 14, and 20 of IFRIC 12, the operator recognizes revenue for the construction, development, acquisition, upgrade, and operation services it provides. Under paragraph 8 of IFRIC 12, the operator derecognizes an asset that it held and recognized as property, plant, and equipment before entering the service concession arrangement.

(b) The grantor recognizes a liability when it grants the operator the right to earn revenue from third-party users of the service concession asset or another revenue-generating asset. Under paragraph 26 of IFRIC 12, the operator recognizes an intangible asset.

(c) The grantor derecognizes an asset it grants to the operator and over which it no longer has control. Under paragraph 27 of IFRIC 12, the operator recognizes the asset and a liability in respect of any obligations it has assumed in exchange for the asset.

AG2. Paragraph 9 of this Standard specifies the conditions under which an asset, other than a whole-of-life asset, is within the scope of the Standard. Paragraph 10 of the Standard specifies the condition under which whole-of-life assets are within the scope of the Standard.

Definitions (see paragraph 8)

AG3. Paragraph 8 defines a service concession arrangement. Common features of a service concession arrangement are:

(a) The grantor is a public sector entity;

(b) The operator is responsible for at least some of the management of the service concession asset and related services and does not merely act as an agent on behalf of the grantor;

(c) The arrangement sets the initial prices to be levied by the operator and regulates price revisions over the period of the service concession arrangement;

(d) The operator is obliged to hand over the service concession asset to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it; and

(e) The arrangement is governed by a binding arrangement that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes.

AG4. Paragraph 8 defines a service concession asset. Examples of service concession assets are: roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks, permanent installations for military and other operations, and other non-current tangible or intangible assets used for administrative purposes in delivering public services.

Recognition and Initial Measurement of a Service Concession Asset (see paragraphs 9–13)

Recognition of a Service Concession Asset

AG5. The assessment of whether a service concession asset should be recognized in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset) is made on the basis of all of the facts and circumstances of the arrangement.

AG6. The control or regulation referred to in paragraph 9(a) could be by a binding arrangement, or otherwise (such as through a third party regulator that regulates other entities that operate in the same industry or sector as the grantor), and includes circumstances in which the grantor buys all of the output as well as those in which some or all of the output is bought by other users. The ability to exclude or regulate the access of others to the benefits of an asset is an essential element of control that distinguishes an entity's assets from those public goods that all entities have access to and benefit from. The binding arrangement sets the initial prices to be levied by the operator and regulates price revisions over the period of the service concession arrangement. When the binding arrangement conveys the right to control the use of the service concession asset to the grantor, the asset meets the condition specified in paragraph 9(a) regarding control in relation to those to whom the operator must provide services.

AG7. For the purpose of paragraph 9(a), the grantor does not need to have complete control of the price: it is sufficient for the price to be regulated by the grantor, binding arrangement, or a third party regulator that regulates other entities that operate in the same industry or sector (e.g., hospitals, schools, or universities) as the grantor (e.g., by a capping mechanism). However, the condition is applied to the substance of the agreement. Non-substantive features, such as a cap that will apply only in remote circumstances, are ignored. Conversely, if, for example, an arrangement purports to give the operator freedom to set prices, but any excess profit is returned to the grantor, the operator's return is capped and the price element of the control test is met.

AG8. Many governments have the power to regulate the behavior of entities operating in certain sectors of the economy, either directly, or through specifically created agencies. For the purpose of paragraph 9(a), the broad regulatory powers described above do not constitute control. In this Standard, the term "regulate" is intended to be applied only in the context of the specific terms and conditions of the service concession arrangement. For example, a regulator of rail services may determine rates that apply to the rail industry as a whole. Depending on the legal framework in a jurisdiction, such rates may be implicit in the binding arrangement governing a service concession arrangement involving the provision of railway transportation, or they may be specifically referred to therein. However, in both cases, the control of the service concession asset is derived from either the contract, or similar binding arrangement, or from the specific regulation applicable to rail services and not from the fact that the grantor is a public sector entity that is related to the regulator of rail service.

AG9. For the purpose of paragraph 9(b), the grantor's control over any significant residual interest should both restrict the operator's practical ability to sell or pledge the asset and give the grantor a continuing right of use throughout the period of the service concession arrangement. The residual interest in the asset is the estimated current value of the asset as if it were already of the age and in the condition expected at the end of the period of the service concession arrangement.

AG10. Control should be distinguished from management. If the grantor retains both the degree of control described in paragraph 9(a) and any significant residual interest in the asset, the operator is only managing the asset on the grantor's behalf—even though, in many cases, it may have wide managerial discretion.

AG11. The conditions in paragraphs 9(a) and 9(b) together identify when the asset, including any replacements required, is controlled by the grantor for the whole of its economic life. For example, if the operator has to replace part of an asset during the period of the arrangement (e.g., the top layer of a road or the roof of a building), the asset is considered as a whole. Thus the condition in paragraph 9(b) is met for the whole of the asset, including the part that is replaced, if the grantor controls any significant residual interest in the final replacement of that part.

AG12. Sometimes the use of a service concession asset is partly regulated in the manner described in paragraph 9(a) and partly unregulated. However, these arrangements take a variety of forms:

(a) Any asset that is physically separable and capable of being operated independently and meets the definition of a cash-generating unit as defined in IPSAS 26, *Impairment of Cash-Generating Assets* is analyzed separately to determine whether the condition set out in paragraph 9(a) is met if it is used wholly for unregulated purposes (e.g., this might apply to a private wing of a hospital, where the remainder of the hospital is used by the grantor to treat public patients); and

(b) When purely ancillary activities (such as a hospital shop) are unregulated, the control tests are applied as if those services did not exist, because in cases in which the grantor controls the services in the manner described in paragraph 9(a), the existence of ancillary activities does not detract from the grantor's control of the service concession asset.

AG13. The operator may have a right to use the separable asset described in paragraph AG12(a), or the facilities used to provide ancillary unregulated services described in paragraph AG12(b). In either case, there may in substance be a lease from the grantor to the operator; if so, it is accounted for in accordance with IPSAS 43.

Existing Asset of the Grantor

AG14. The arrangement may involve an existing asset of the grantor:

(a) To which the grantor gives the operator access for the purpose of the service concession arrangement; or

(b) To which the grantor gives the operator access for the purpose of generating revenues as compensation for the service concession asset.

AG15. The requirement in paragraph 11 is to measure assets recognized in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset) initially at fair value. Existing assets of the grantor used in the service concession arrangement are reclassified rather than recognized under this Standard. Only an upgrade to an existing asset of the grantor (e.g., that increases its capacity) is recognized as a service concession asset in accordance with paragraph 9, or paragraph 10 for a whole-of-life asset).

AG16. In applying the impairment tests in IPSAS 17 or IPSAS 31, as appropriate, the grantor does not necessarily consider the granting of the service concession to the operator as a circumstance that causes impairment, unless there has been a change in use of the asset that affects its future economic benefits or service potential. The grantor refers to IPSAS 21, *Impairment of Non-Cash-Generating Assets* or IPSAS 26, as appropriate, to determine whether any of the indicators of impairment have been triggered under such circumstances.

AG17. If the asset no longer meets the conditions for recognition in paragraph 9 (or paragraph 10 for a whole-of-life asset), the grantor follows the derecognition principles in IPSAS 17 or IPSAS 31, as appropriate. For example, if the asset is transferred to the operator on a permanent basis, it is derecognized. If the asset is transferred on a temporary basis, the grantor considers the substance of this term of the service concession arrangement in determining whether the asset should be derecognized. In such cases, the grantor also considers whether the arrangement is a lease transaction or a sale and leaseback transaction that should be accounted for in accordance with IPSAS 43.

AG18. When the service concession arrangement involves upgrading an existing asset of the grantor such that the future economic benefits or service potential the asset will provide are increased, the upgrade is assessed to determine whether it meets the conditions for recognition in paragraph 9 (or paragraph 10 for a whole-of-life asset). If those conditions are met, the upgrade is recognized and measured in accordance with this Standard.

Existing Asset of the Operator

AG19. The operator may provide an asset for use in the service concession arrangement that it has not constructed, developed, or acquired. If the arrangement involves an existing asset of the operator which the operator uses for the purpose of the service concession arrangement, the grantor determines whether the asset meets the conditions in paragraph 9 (or paragraph 10 for a whole-of-life asset). If the conditions for recognition are met, the grantor recognizes the asset as a service concession asset and accounts for it in accordance with this Standard.

Constructed or Developed Asset

AG20. Where a constructed or developed asset meets the conditions in paragraph 9 (or paragraph 10 for a whole-of-life asset) the grantor recognizes and measures the asset in accordance with this Standard. IPSAS 17 or IPSAS 31, as appropriate, set out the criteria for when a service concession asset should be recognized. Both IPSAS 17 and IPSAS 31 require that an asset shall be recognized if, and only if:

(a) It is probable that future economic benefits or service potential associated with the item will flow to the entity; and

(b) The cost or fair value of the item can be measured reliably[2].

AG21. Those criteria, together with the specific terms and conditions of the binding arrangement, need to be considered in determining whether to recognize the service concession asset during the period in which the asset is constructed or developed. For both property, plant, and equipment and intangible assets, the recognition criteria may be met during the construction or development period, and, if so, the grantor will normally recognize the service concession asset during that period.

AG22. The first recognition criterion requires the flow of economic benefits or service potential to the grantor. From the grantor's point of view, the primary purpose of a service concession asset is to provide service potential on behalf of the public sector grantor. Similar to an asset the grantor constructs or develops for its own use, the grantor would assess, at the time the costs of construction or development are incurred, the terms of the binding arrangement to determine whether the service potential of the service concession asset would flow to the grantor at that time.

AG23. The second recognition criterion requires that the initial cost or fair value of the asset can be measured reliably. Accordingly, to meet the recognition criteria in IPSAS 17 or IPSAS 31, as appropriate, the grantor must have reliable information about

[2] Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent. Paragraph BC16 of IPSAS 1 discusses the transitional approach to the explanation of reliability.

the cost or fair value of the asset during its construction or development. For example, if the service concession arrangement requires the operator to provide the grantor with progress reports during the asset's construction or development, the costs incurred may be measurable, and would therefore meet the recognition principle in IPSAS 17 for constructed assets or in IPSAS 31 for developed assets. Also, where the grantor has little ability to avoid accepting an asset constructed or developed to meet the specifications of the contract, or a similar binding arrangement, the costs are recognized as progress is made towards completion of the asset. Thus, the grantor recognizes a service concession asset and an associated liability.

Measurement of Service Concession Assets

AG24. Paragraph 11 requires service concession assets recognized in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset) to be measured initially at fair value. In particular, fair value is used to determine the cost of a constructed or developed service concession asset or the cost of any upgrades to existing assets, on initial recognition. The requirement in paragraph 11 does not apply to existing assets of the grantor that are reclassified as service concession assets in accordance with paragraph 12 of this Standard. The use of fair value on initial recognition does not constitute a revaluation under IPSAS 17 or IPSAS 31.

AG25. The type of compensation exchanged between the grantor and the operator affects how the fair value of the service concession asset is determined on initial recognition. The paragraphs that follow outline how to determine the fair value of the asset on initial recognition based on the type of compensation exchanged:

(a) Where payments are made by the grantor to the operator, the fair value on initial recognition of the asset represents the portion of the payments paid to the operator for the asset.

(b) Where the grantor does not make payments to the operator for the asset, the asset is accounted for in the same way as an exchange of non-monetary assets in IPSAS 17 and IPSAS 31.

Types of Compensation

AG26. Service concession arrangements are rarely if ever the same; technical requirements vary by sector and by jurisdiction. Furthermore, the terms of the arrangement may also depend on the specific features of the overall legal framework of the particular jurisdiction. Contract laws, where they exist, may contain terms that do not have to be repeated in individual contracts.

AG27. Depending on the terms of the service concession arrangement, the grantor may compensate the operator for the service concession asset and service provision by any combination of the following:

(a) Making payments (e.g., cash) to the operator;

(b) Compensating the operator by other means, such as:

(i) Granting the operator the right to earn revenue from third-party users of the service concession asset; or

(ii) Granting the operator access to another revenue-generating asset for its use.

AG28. Where the grantor compensates the operator for the service concession asset by making payments to the operator, the asset and service components of the payments may be separable (e.g., the binding arrangement specifies the amount of the predetermined series of payments to be allocated to the service concession asset) or inseparable.

Separable Payments

AG29. A service concession arrangement may be separable in a variety of circumstances, including, but not limited to, the following:

(a) Part of a payment stream that varies according to the availability of the service concession asset itself and another part that varies according to usage or performance of certain services are identified;

(b) Different components of the service concession arrangement run for different periods or can be terminated separately. For example, an individual service component can be terminated without affecting the continuation of the rest of the arrangement; or

(c) Different components of the service concession arrangement can be renegotiated separately. For example, a service component is market tested and some or all of the cost increases or reductions are passed on to the grantor in such a way that the part of the payment by the grantor that relates specifically to that service can be identified.

AG30. IPSAS 17 and IPSAS 31 require initial measurement of an asset acquired in an exchange transaction at cost, which is the cash price equivalent of the asset. For exchange transactions, the transaction price is considered to be fair value, unless indicated otherwise. Where the asset and service components of payments are separable, the cash price equivalent of the service concession asset is the present value of the service concession asset component of the payments. However, if the present value of the asset portion of the payments is greater than fair value, the service concession asset is initially measured at its fair value.

Inseparable Payments

AG31. Where the asset and service component of payments by the grantor to the operator are not separable, the fair value in paragraph 11 is determined using estimation techniques.

AG32. For the purpose of applying the requirements of this Standard, payments and other consideration required by the arrangement are allocated at the inception of the arrangement or upon a reassessment of the arrangement into those for the service concession asset and those for other components of the service concession arrangement (e.g., maintenance and operation services) on the basis of their relative fair values. The fair value of the service concession asset includes only amounts related to the asset and excludes amounts for other components of the service concession arrangement. In some cases, allocating the payments for the asset from payments for other components of the service concession arrangement will require the grantor to use an estimation technique. For example, a grantor may estimate the payments related to the asset by reference to the fair value of a comparable asset in an agreement that contains no other components, or by estimating the payments for the other components in the service concession arrangement by reference to comparable arrangements and then deducting these payments from the total payments under the arrangement.

Operator Receives Other Forms of Compensation

AG33. The types of transactions referred to in paragraph 17(b) are non-monetary exchange transactions. Paragraph 38 of IPSAS 17 and paragraph 44 of IPSAS 31, as appropriate, provide guidance on these circumstances.

AG34. When the operator is granted the right to earn revenue from third-party users of the service concession asset, or another revenue-generating asset, or receives non-cash compensation from the grantor, the grantor does not incur a cost directly for acquiring the service concession asset. These forms of compensation to the operator are intended to compensate the operator both for the cost of the service concession asset and for operating it during the term of the service concession arrangement. The grantor therefore needs to initially measure the asset component in a manner consistent with paragraph 11.

Subsequent Measurement

AG35. After initial recognition, a grantor applies IPSAS 17 and IPSAS 31 to the subsequent measurement and derecognition of a service concession asset. IPSAS 21 and IPSAS 26 are also applied in considering whether there is any indication that a service concession asset is impaired. These requirements in these Standards are applied to all assets recognized or classified as service concession assets in accordance with this Standard.

Recognition and Measurement of Liabilities (see paragraphs 14–28)

AG36. The grantor recognizes a liability in accordance with paragraph 14 only when a service concession asset is recognized in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset). The nature of the liability recognized in accordance with paragraph 14 differs in each of the circumstances described in paragraph AG25 according to its substance.

The Financial Liability Model (see paragraphs 18–23)

AG37. When the grantor has an unconditional obligation to make a predetermined series of payments to the operator, the liability is a financial liability as defined in IPSAS 41. The grantor has an unconditional obligation if it has little, if any, discretion to avoid the obligation usually because of the binding arrangement with the operator being enforceable by law.

AG38. When the grantor provides compensation to the operator for the cost of the service concession asset and service provision in the form of a predetermined series of payments, an amount reflecting the portion of the predetermined series of payments that pertains to the asset is recognized as a liability in accordance with paragraph 14. This liability does not include the finance charge and service components of the payments specified in paragraph 21.

AG39. Where the grantor makes any payments to the operator in advance of the service concession asset being recognized, the grantor accounts for those payments as prepayments.

AG40. The finance charge specified in paragraph 21 is determined based on the operator's cost of capital specific to the service concession asset, if this is practicable to determine.

AG41. If the operator's cost of capital specific to the service concession asset is not practicable to determine, the rate implicit in the arrangement specific to the service concession asset, the grantor's incremental borrowing rate, or another rate appropriate to the terms and conditions of the arrangement, is used.

AG42. Where sufficient information is not available, the rate used to determine the finance charge may be estimated by reference to the rate that would be expected on acquiring a similar asset (e.g., a lease of a similar asset, in a similar location and for a similar term). The estimate of the rate should be reviewed together with:

(a) The present value of the payments;

(b) The assumed fair value of the asset; and

(c) The assumed residual value, to ensure all figures are reasonable and mutually consistent.

AG43. In cases when the grantor takes part in the financing (e.g., by lending the operator the funds to construct, develop, acquire, or upgrade a service concession asset, or through guarantees), it may be appropriate to use the grantor's incremental borrowing rate to determine the finance charge.

AG44. The interest rate used to determine the finance charge may not be subsequently changed unless the asset component or the whole of the arrangement is renegotiated.

AG45. The finance charge related to the liability in a service concession arrangement is presented consistently with other finance charges in accordance with IPSAS 28, IPSAS 30, and IPSAS 41.

AG46. The service component of payments determined in accordance with paragraph 21 is ordinarily recognized evenly over the term of the service concession arrangement because this pattern of recognition best corresponds to the service provision. In cases when specific expenses are required to be separately compensated, and their timing is known, such expenses are recognized as incurred.

Grant of a Right to the Operator Model (see paragraphs 24–26)

AG47. When the grantor compensates the operator for the service concession asset and service provision by granting the operator the right to earn revenue from third-party users of the service concession asset, the operator is granted the right to earn revenue over the period of the service concession arrangement. Likewise, the grantor earns the benefit associated with the assets received in the service concession arrangement in exchange for the right granted to the operator over the period of the arrangement. Accordingly, the revenue is not recognized immediately. Instead, a liability is recognized for any portion of the revenue that is not yet earned. Revenue is recognized and the liability reduced in accordance with paragraph 25 based on the economic substance of the service concession arrangement, usually as access to the service concession asset is provided to the operator over the term of the service concession arrangement. As described in paragraph AG27, the grantor may compensate the operator by a combination of payments and granting a right to earn revenue directly from third-party users. In such cases, if the operator's right to earn such third-party revenues significantly reduces or eliminates the grantor's predetermined series of payments to the operator, another basis may be more appropriate for reducing the liability (e.g., the term over which the grantor's future predetermined series of payments are reduced or eliminated).

AG48. When the grantor compensates the operator for the service concession asset and service by the provision of a revenue-generating asset, other than the service concession asset, revenue is recognized and the liability recognized in accordance with paragraph 24 is reduced in a manner similar to that described in paragraph AG47. In such cases, the grantor also considers the derecognition requirements in IPSAS 17 or IPSAS 31, as appropriate.

AG49. In some cases under the grant of a right to the operator model, there may be a "shadow toll". Some shadow tolls are paid for the construction, development, acquisition, or upgrade of the service concession asset, and its operation by the operator. In cases where the grantor pays the operator solely for the usage of the service concession asset by third-party users, such payment is compensation in exchange for the usage and not the acquisition of the service concession asset. Accordingly, such payments do not relate to the liability specified in paragraph AG48. The grantor compensates the operator only to the extent of the usage of the service concession asset, and accounts for such payments as expenses in accordance with IPSAS 1.

Dividing the Arrangement (see paragraphs 27–28)

AG50. If the operator is compensated for the service concession asset partly by a predetermined series of payments and partly by receiving the right to earn revenue from third-party use of either the service concession asset or another revenue-generating asset, it is necessary to account separately for each portion of the liability related to the grantor's consideration. In these circumstances, the consideration to the operator is divided into a financial liability portion for the predetermined series of payments and a liability portion for the right granted to the operator to earn revenue from third-party use of the service concession asset or another revenue-generating asset. Each portion of the liability is recognized initially at the fair value of the consideration paid or payable.

Other Liabilities, Commitments, Contingent Liabilities and Contingent Assets (see paragraph 29)

AG51. Service concession arrangements may include various forms of financial guarantees (e.g., a guarantee, security, or indemnity related to the debt incurred by the operator to finance construction, development, acquisition, or upgrade of a service concession asset), or performance guarantees (e.g., guarantee of minimum revenue streams, including compensation for short-falls).

AG52. Certain guarantees made by a grantor may meet the definition of a financial guarantee contract. The grantor determines whether guarantees made by the grantor as part of a service concession arrangement meet the definition of a financial guarantee contract and applies IPSAS 28, IPSAS 30, and IPSAS 41 in accounting for the guarantee. Where the guarantee is an insurance contract, the grantor can elect to apply the relevant international or national accounting standard dealing with insurance contracts. See IPSAS 28, paragraphs AG3–AG9 for further guidance.

AG53. Guarantees and commitments that do not meet the requirements in IPSAS 28 and IPSAS 41 relating to financial guarantee contracts or are not insurance contracts are accounted for in accordance with IPSAS 19.

AG54. Contingent assets or liabilities may arise from disputes over the terms of the service concession arrangement. Such contingencies are accounted for in accordance with IPSAS 19.

Other Revenues (see paragraph 30)

AG55. The operator may compensate the grantor for access to the service concession asset by providing the grantor with a series of predetermined inflows of resources, including the following:

(a) An upfront payment or a stream of payments;

(b) Revenue-sharing provisions;

(c) A reduction in a predetermined series of payments the grantor is required to make to the operator; and

(d) Rent payments for providing the operator access to a revenue-generating asset.

AG56. When the operator provides an upfront payment, a stream of payments, or other consideration to the grantor for the right to use the service concession asset over the term of the service concession arrangement, the grantor accounts for these payments in accordance with IPSAS 9. The timing of the revenue recognition is determined by the terms and conditions of the service concession arrangement that specify the grantor's obligation to provide the operator with access to the service concession asset.

AG57. Where the operator provides an upfront payment, a stream of payments, or other consideration to the grantor in addition to the service concession asset, for the right to earn the revenue from third-party use of the service concession asset, or another revenue-generating asset, any portion of the payments received from the operator not earned in the accounting period is recognized as a liability until the conditions for revenue recognition are met.

AG58. When the conditions for revenue recognition are met, the liability is reduced as the revenue is recognized in accordance with paragraph 30.

AG59. However, given the varying nature of the types of assets that may be used in service concession arrangements, and the number of years over which the arrangements operate, there may be more appropriate alternative methods for recognizing revenue associated with the inflows specified in the binding arrangement that better reflect the operator's economic consumption of their access to the service concession asset and/or the time value of money. For example, an annuity method that applies a compounding interest factor that more evenly recognizes revenue on a discounted basis, as opposed to on a nominal basis, may be more appropriate for a service concession arrangement with a term extending over several decades.

AG60. When an upfront payment is received from the operator, the revenue is recognized in a way that best reflects the operator's economic consumption of its access to the service concession asset and/or the time value of money. For example, when the operator is required to pay annual installments over the term of the service concession arrangement, or predetermined sums for specific years, the revenue is recognized over the specified term.

AG61. For service concession arrangements under which the operator is granted the right to earn revenue from third-party users of the service concession asset, revenue relates to the inflow of economic benefits received as the services are provided and is therefore recognized on the same basis as the liability is reduced. In these cases, the grantor will often negotiate to include a revenue-sharing provision in the arrangement with the operator. Revenue-sharing as part of a service concession arrangement may be based on all revenue earned by the operator, or on revenue above a certain threshold, or on revenue more than the operator needs to achieve a specified rate of return.

AG62. The grantor recognizes revenue generated from revenue-sharing provisions in service concession arrangements as it is earned, in accordance with the substance of the relevant agreement, after any contingent event (e.g., the achievement of a revenue threshold) is deemed to have occurred. The grantor applies IPSAS 19 to determine when the contingent event has occurred.

AG63. A reduction in the future predetermined series of payments the grantor would otherwise be required to make to the operator provides the grantor with upfront non-cash consideration. Such revenue is recognized as the liability is reduced.

AG64. When the operator pays a nominal rent for access to a revenue-generating asset, the rental revenue is recognized in accordance with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

Presentation and Disclosure (see paragraphs 31–33)

AG65. Disclosures relating to various aspects of service concession arrangements may be addressed in existing Standards. This Standard addresses only the additional disclosures relating to service concession arrangements. Where the accounting for a particular aspect of a service concession arrangement is addressed in another Standard, the grantor follows the disclosure requirements of that Standard in addition to those set out in paragraph 32.

AG66. IPSAS 1 requires finance costs to be presented separately in the statement of financial performance. The finance charge determined in accordance with paragraph 21 is included in this item.

AG67. In addition to the disclosures outlined in paragraphs 31–33, the grantor also applies the relevant presentation and disclosure requirements in other IPSASs as they pertain to assets, liabilities, revenues, and expenses recognized under this Standard.

Transition (see paragraphs 34–35)

AG68. [Deleted]

AG69. [Deleted]

AG70. [Deleted]

AG71. [Deleted]

AG72. [Deleted]

AG73. [Deleted]

Appendix B

Amendments to Other IPSASs

[Deleted]

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 32.

Objective

BC1. In the absence of an International Public Sector Accounting Standard dealing with service concession arrangements, public sector entities are directed, in IPSAS 1, *Presentation of Financial Statements* to look to other international or national accounting standards. In the case of arrangements involving private sector participation, they would try to apply the principles in Interpretation 12 of the International Accounting Standards Board's International Financial Reporting Interpretations Committee (IFRIC 12), *Service Concession Arrangements*. However, IFRIC 12 addresses accounting by the operator, and does not, therefore, provide guidance for the grantor. The IPSASB believes this Standard will promote consistency and comparability in how service concession arrangements are reported by public sector entities.

Scope

BC2. After considering the various types of arrangements involving public and private sector entities identified in the development of the March 2008 Consultation Paper, *Accounting and Financial Reporting for Service Concession Arrangements*, the IPSASB concluded that the scope of this Standard should be the mirror of IFRIC 12, in particular, the criteria under which the grantor recognizes a service concession asset (see paragraphs BC11–BC16). The rationale for this decision is that this approach would require both parties to the same arrangement to apply the same principles in determining which party should recognize the asset used in a service concession arrangement. Thus, arrangements in which the criteria for recognition of a service concession asset in paragraph 9 (or paragraph 10 for a whole-of-life asset) are not satisfied, are outside the scope of this IPSAS. The IPSASB considers that this approach minimizes the possibility for an asset to be accounted for by both of the parties, or by neither party.

BC3. The IPSASB recognized that the Standard should provide Implementation Guidance on the relevant IPSASs that apply to arrangements outside the scope of the Standard. The Implementation Guidance contains a flowchart illustrating the application of this Standard as well as a table of references to relevant IPSASs for the other types of arrangements that are outside the scope of this Standard.

BC4. The IPSASB concluded that it was important to provide guidance on accounting for the consideration given by the grantor to the operator for the service concession asset. The consideration may give the operator rights to a determinable series of payments of cash or cash equivalents or a right to earn revenue from third-party users of the service concession asset or another revenue-generating asset for its use, or a combination of both types of consideration. Each type of consideration results in specific accounting issues on which the IPSASB has provided guidance to facilitate consistent application of the Standard.

BC5. The IPSASB also concluded that guidance was necessary on applying the general revenue recognition principles in IPSAS 9, *Revenue from Exchange Transactions* to service concession arrangements because of the unique features of some service concession arrangements (e.g., revenue-sharing provisions).

BC6. This Standard does not specify the accounting by operators, because it is addressed in IFRIC 12. In many cases the operator is a private sector entity, and IPSASs are not designed to apply to private sector entities. The operator or the grantor may also be a [Government Business Enterprise (GBE)] (the term in square brackets is no longer used following the issue of *The Applicability of IPSASs* in April 2016). When this Standard was issued, IPSASs were not designed to apply to GBEs. International Financial Reporting Standards (IFRSs) were applied to private sector entities and GBEs.

BC7. Some respondents to ED 43 suggested that the scope of the proposed Standard should be extended to include public-to-public service concession arrangements. The IPSASB noted that addressing the accounting for such arrangements was not the primary purpose of the project which was to address the cases when the grantor is a public sector entity that follows accrual IPSASs. The IPSASB noted that application of this Standard by analogy would be appropriate under paragraphs 12−15 of IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* for the public sector grantor and that relevant international or national accounting standard dealing with service concession arrangements may be applied by the public sector operator

Definitions

BC8. ED 43 did not provide definitions because IFRIC 12 did not do so. Accordingly, ED 43 provided guidance on certain terminology. Respondents to ED 43 proposed that, because this is a Standard and not an Interpretation, it was important to include definitions for consistency in application of the Standard. The IPSASB agreed that this Standard should include definitions.

BC9. The IPSASB agreed not to use the term "infrastructure" to refer to the asset used in a service concession arrangement, even though IFRIC 12 uses the term. The IPSASB noted that the term is used in IPSASs in ways that may not be fully compatible with this Standard. Further, the term has a prescribed meaning in some jurisdictions that differs from that used in IFRIC 12. To ensure clarity that the asset referred to is the one recognized on the basis of the conditions for recognition in paragraph 9 of this Standard (or paragraph 10 for a whole-of-life asset), the asset in this Standard is referred to as the "service concession asset". This term is intended to cover the same types of assets as envisaged in IFRIC 12.

BC10. The term "binding arrangement" had not been defined previously, but has been used in other IPSASs to describe arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract. The IPSASB concluded that for the purposes of this Standard, this term should be defined to ensure consistent application of the Standard.

Recognition of a Service Concession Asset

BC11. The main accounting issue in service concession arrangements is whether the grantor should recognize a service concession asset.

BC12. The IPSASB considered the merits of the risks and rewards and the control-based approach to assess whether the grantor should recognize the asset. The risks and rewards approach focuses on the economic aspects of the terms and conditions in the arrangement. The IPSASB did not believe this focus to be appropriate for service concession arrangements because the primary purpose of a service concession asset, from the grantor's point of view, is to provide specified public services on behalf of the grantor using a service concession asset, and not to provide economic benefits such as revenue generated by such assets (e.g., from user fees). Thus, the service potential of the asset accrues to the grantor. Economic benefits are only likely to arise from a service concession arrangement in circumstances where the operator is granted the right to earn revenue from third-party users, of either the service concession asset or another revenue-generating asset. A control-based approach focuses on control over the economic benefits and the service potential of the service concession asset.

BC13. As it is often the case that service concession arrangements are entered into for the sharing of risks between the grantor and the operator, the IPSASB also questioned whether sufficiently objective criteria could be established for assessing risks and rewards to enable consistent results to be determined. In addition, weighting of various risks and rewards was seen to be problematic. The IPSASB concluded, therefore, that the risks and rewards approach is inappropriate.

BC14. The IPSASB also considered whether a rights and obligations approach was appropriate. Although such an approach could have conceptual merit, the IPSASB believes that it would represent a significant change in the accounting and financial reporting of assets and liabilities for public sector entities that could have implications beyond service concession arrangements. Given the IPSASB's decision to complement IFRIC 12, which uses a control-based approach, the IPSASB agreed that a rights and obligations approach was not appropriate for this Standard.

BC15. The IPSASB concluded that a control-based approach was the most effective means to determine whether the grantor should recognize the asset. The IPSASB concluded that if a control-based approach is used, it should be consistent with IFRIC 12, for the same reasons cited in paragraph BC2. Accordingly, this Standard addresses only arrangements in which the grantor (a) controls or regulates the services provided by the operator, and (b) controls any significant residual interest in the service concession asset at the end of the term of the arrangement. Consistent with IFRIC 12, in the case of whole-of-life assets, only condition (a) must be met for recognition of a service concession asset. The IPSASB concluded that it was important to stress that a service concession arrangement is a binding arrangement. Accordingly, the assessment of whether a service concession asset should be recognized is made on the basis of all of the facts and circumstances of the arrangement.

BC16. Paragraph 9(a) of this Standard is consistent with paragraph 5 of IFRIC 12. It is intended to apply only to the regulation that is specific to the service concession arrangement, and not to the broad understanding of public sector regulatory powers from the grantor's point of view. The regulation referred to in paragraph 9(a) of this Standard is either by contract or through a regulator. Guidance is provided in paragraph AG6 on applying the term "regulates" in paragraph 9(a) to determine whether the grantor should recognize a service concession asset. Some respondents to ED 43 asserted that providing such additional guidance creates an asymmetry with IFRIC 12, as there is no additional guidance on the meaning of this term. The IPSASB considers the additional guidance provided in paragraph AG6 is necessary to ensure symmetry exists between the public sector grantor's and the private sector operator's application of the "regulates" criterion in determining whether to recognize the service concession asset, as the public sector may have considered the term in the context of the broad regulatory powers of governments.

Recognition of a Liability

BC17. ED 43 described two circumstances that may give rise to a liability when the grantor recognizes a service concession asset, based on the nature of the consideration due to the operator in exchange for the service concession asset.

BC18. ED 43 proposed that when the grantor recognizes a service concession asset, a liability shall also be recognized. The ED noted that this liability may be any combination of a financial liability and a performance obligation. ED 43 proposed that a financial liability occurs when the grantor has a determinable series of cash payments of cash or cash equivalents to make to the operator and a performance obligation occurs when the grantor compensates the operator by granting the operator the right to charge users of the service concession asset or by granting the operator access to another revenue-generating asset for its use. ED 43 proposed that the grantor account for the performance obligation in accordance with IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.

BC19. Respondents to ED 43 sought clarification on this issue, particularly with respect to the "performance obligation" identified in ED 43. Respondents' concerns are summarized below.

(a) The right to charge users of the service concession asset or by granting the operator access to another revenue-generating asset was seen by some respondents as independent of the compensation for the asset. These respondents highlighted that the requirement to provide access is a feature of most service concession arrangements, and if this is to be recognized, such recognition should not be dependent on the non-occurrence of a payment stream from the grantor to the operator.

(b) While being described as a performance obligation, there is no obligation for an outflow of economic resources from the grantor in future periods. These respondents therefore question whether a liability as defined in IPSAS 1, or a provision as defined in IPSAS 19 could be fairly represented to exist.

BC20. In addition, a number of other respondents, possibly as a result of the above concerns, requested clarification of the meaning of "performance obligation" in the ED. A few of these respondents queried whether the substance of the nature of this "balancing item" was deferred revenue.

BC21. The IPSASB agreed that clarification of this issue was required. The IPSASB noted that using the term "performance obligation" could give rise to confusion because it is used in IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* in relation to non-exchange transactions. The IPSASB noted that a service concession arrangement is an exchange transaction rather than a non-exchange transaction and therefore it would be preferable not to use the term performance obligation in relation to exchange transactions.

BC22. In IFRIC 12, when the operator does not control the service concession asset, the operator recognizes either a financial asset, or an intangible asset, depending on which party bears the demand risk. The IPSASB agreed that, to maintain symmetry with IFRIC 12, the same approach should be adopted for the grantor. Thus, two models are identified for accounting for the credit when the grantor recognizes a service concession asset in accordance with this Standard: the financial liability model, and the grant of a right to the operator model (which replaces the "performance obligation").

BC23. The IPSASB's decision to amend the terminology used in ED 43 from "performance obligation" to the Standard's use of "liability" does not change the grantor's accounting treatment of a service concession arrangement from that proposed in ED 43.

The Financial Liability Model

BC24. Where the grantor compensates the operator by the delivery of cash or another financial asset in exchange for its control of a service concession asset, IFRIC 12 classifies this type of arrangement as the "financial asset model" because the operator receives a financial asset. This Standard refers to this type of arrangement as the "financial liability model" because the grantor has a financial liability.

BC25. A financial liability arises in cases when the grantor is obligated to make a determinable series of payments to the operator because the grantor has an obligation as a result of the binding arrangement to deliver cash or another financial asset to another entity (the operator). The IPSASB concluded further that when there is a determinable series of payments of cash or cash equivalents, the payments should be allocated as a reduction of the liability, an imputed finance charge, and charges for services provided by the operator under the service concession arrangement.

BC26. Service concession arrangements are concluded by way of a binding arrangement, which may include contracts or similar arrangements that confer similar rights and obligations on the parties as if they were in the form of a contract. The IPSASB concluded that, if similar arrangements exist that confer the same rights and obligations on either party as if they were in the form of a contract, IPSAS 28, *Financial Instruments: Presentation*, IPSAS 30, *Financial Instruments: Disclosures,* and IPSAS 41, *Financial Instruments* should be applied by analogy to such arrangements.

BC27. In considering a departure from this aspect of IFRIC 12, the IPSASB noted that the main features of IFRIC 12 that were the subject of the "mirror" approach to developing this Standard were limited to the scope of the arrangements to be included and the recognition and disclosure requirements.

BC28. IFRIC 12 requires the financial asset to be accounted for in accordance with the IFRS on financial instruments. This Standard provides guidance for determining the interest rate to be used to determine the finance charge under the financial liability model. The IPSASB considered the grantor ordinarily would not have sufficient information to determine a market rate. Accordingly, the guidance requires the operator's cost of capital to be used, if that is practicable to determine. It also permits other rates to be used appropriate to the specific terms and conditions of the service concession arrangement.

Grant of a Right to the Operator Model

BC29. In responding to the issues raised by respondents to ED 43, the IPSASB reconsidered the nature of the consideration given by the grantor for the service concession asset where the operator recoups the price of the asset from earning revenue from third-party users of the service concession asset or another revenue-generating asset. The IPSASB noted that in this situation, the cash consideration for the service concession asset is not being met by the grantor but by users of the service concession asset or other revenue-generating asset. The economic substance of this arrangement provides an increase in net assets to the grantor, and therefore revenue accrues and should be recognized. As the service concession arrangement is an exchange transaction, the Board referred to IPSAS 9 when considering the nature of the revenue and the timing of the recognition of that revenue.

BC30. Where the operator bears the demand risk, the grantor compensates the operator by the grant of a right (e.g., a license) to charge users of the public service related to the service concession asset or of another revenue-generating asset. The grantor provides the operator access to the asset in order for the operator to be compensated for construction, development, acquisition, or upgrade of the service concession asset. IFRIC 12 classifies this type of arrangement as the "intangible asset model." This Standard refers to this type of arrangement as the "grant of a right to the operator model."

BC31. The IPSASB therefore considered whether the credit should be accounted for as a liability, as a direct increase to net assets/equity, or as revenue.

BC32. It was agreed that, in this circumstance, the grantor does not have a liability because the service concession arrangement is an exchange of assets, with the service concession asset being obtained by the grantor in exchange for a transfer of rights to the operator to earn revenue from third-party users of the asset over the period of the service concession arrangement.

BC33. Some respondents to ED 43 indicated that the credit should be treated as net assets/equity, consistent with IPSAS 1, which defines net assets/equity as the residual interest in the assets of the entity after deducting all its liabilities. IPSAS 1 envisages four components of net assets/equity. Those components include:

(a) Contributed capital, being the cumulative total at the reporting date of contributions from owners, less distributions to owners;

(b) Accumulated surpluses or deficits;

(c) Reserves, including a description of the nature and purpose of each reserve within net assets/equity; and

(d) Non-controlling interests.

BC34. The IPSASB concluded that the credit did not represent a direct increase in the grantor's net assets/equity because the credit is not one of the components of net assets/equity identified in paragraph BC33 for the reasons noted below:

(a) Contributions from owners are defined as "future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which: (a) Conveys entitlement both to (i) distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to (ii) distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or (b) Can be sold, exchanged, transferred, or redeemed." The credit related to the recognition of a service concession asset does not meet this definition because the operator has not made a contribution to the grantor that results in a financial interest in the entity by the operator as envisaged by IPSAS 1.

(b) Accumulated surplus/deficit is an accumulation of an entity's surpluses and deficits. The credit related to recognition of a service concession asset represents an individual transaction and not an accumulation.

(c) Reserves generally arise from items recognized directly in net assets/equity from specific requirements in IPSASs, and may include, for example, gains and losses on revaluation of assets (e.g., property, plant, and equipment, investments). The credit related to the recognition or reclassification of a service concession asset does not represent a gain or loss specified to be directly recognized in net/assets equity because it involves an exchange transaction and not a revaluation of an existing asset of the grantor. Existing assets of the grantor, when used in a service concession arrangement and continue to meet the control criteria in this Standard, are reclassified, thus no revaluation is done.

(d) A non-controlling interest is defined as "that portion of the surplus or deficit and net assets/equity of a controlled entity attributable to net assets/equity interests that are not owned, directly or indirectly, through controlled entities, by the controlling entity." A non-controlling interest may arise, for example, when at the whole-of-government level, the economic entity includes a commercial public sector entity that has been partly privatized. Accordingly, there may be private shareholders who have a financial interest in the net assets/equity of the entity. The credit related to the recognition of a service concession asset does not meet this definition because operator does not have such a financial interest in the grantor.

BC35. The IPSASB agreed that the credit represents revenue. As a service concession arrangement is an exchange transaction, the IPSASB referred to IPSAS 9 when considering the nature of the revenue and the timing of the recognition of that revenue. In accordance with IPSAS 9, when goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction that generates revenue as it results in an increase in the net assets of the grantor. In this situation, the grantor has received a service concession asset in exchange for granting a right (a license) to the operator to charge the third party users of the public service that it provides on the grantor's behalf. The service concession asset recognized by the grantor and the right (intangible asset) recognized by the operator are dissimilar. However, until the criteria for recognition of revenue have been satisfied, the credit is recognized as a liability.

BC36. The IPSASB noted that, in this situation, there is no cash inflow to equal the revenue recognized. This result is consistent with IPSAS 9 in which an entity provides goods or services in exchange for another dissimilar asset that is subsequently used to generate cash revenues.

BC37. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

BC38. IPSAS 9 identifies three types of transaction that give rise to revenue: the rendering of services, the sale of goods (or other assets) and revenue arising from the use by others of the entity's assets, yielding interest, royalties, and dividends. In considering the nature of the revenue, the IPSASB considered these types of transactions separately.

BC39. The IPSASB considered the approaches to revenue recognition set out in IPSAS 9 in relation to the "grant of a right to the operator" model and concluded that none of those scenarios fully met the circumstances of this model. Nevertheless, the IPSASB noted that the timing of revenue recognition under each of them is over the term of the arrangement, rather than immediately. The IPSASB determined that, by analogy, such a pattern of revenue recognition was also appropriate for recognizing the revenue arising from the liability related to this model. As a result, until the criteria for recognition of revenue have been satisfied, the credit is recognized as a liability.

BC40. The IPSASB considered whether the grantor should recognize the operating expenses in the circumstances described in paragraph BC30 relating to the grant of a right to the operator model. The IPSASB noted that the grantor's liability recognized relates solely to the service concession asset received by the grantor. If the service expenses were recognized, the grantor would also have to recognize annually imputed revenue equal to the annual expense. The IPSASB did not believe this accounting would provide useful information, because revenue and an expense of equal amounts would be recognized annually. The IPSASB noted further that reliable information about the operator's expenses may not be available in any case. The IPSASB therefore concluded that the grantor should not recognize operating expenses associated with the service concession arrangement in the circumstances described in paragraph BC30.

Accounting Issues Addressed in Other IPSASs

BC41. Because of the complexity of many service concession arrangements, there may be additional accounting issues related to certain terms in the contract, or a similar binding arrangement (e.g., revenues, expenses, guarantees, and contingencies). The IPSASB agreed that it was not necessary to repeat such existing guidance in this Standard. Accordingly, when an existing IPSAS specifies the accounting and reporting for a component of a service concession arrangement, that IPSAS is referred to in this Standard and no additional guidance is provided. However, the IPSASB noted some cases (e.g., revenue recognition), when the application of such IPSASs would be difficult given certain unique features in service concession arrangements. To ensure consistent implementation of this Standard, the IPSASB provided specific guidance on how the principles in the other IPSAS would be applied.

Transition

BC42. This Standard requires an entity that has previously recognized service concession assets and related liabilities, revenues, and expenses to apply this Standard retrospectively in accordance with IPSAS 3. The Standard also requires an entity that has not previously recognized service concession assets and related liabilities, revenues, and expenses and uses the accrual basis of accounting to apply this Standard either retrospectively or prospectively using deemed cost from the beginning of the earliest period for which comparative information is presented in the financial statements.

BC43. The general requirement in IPSAS 3 is that the changes should be accounted for retrospectively, except to the extent that retrospective application would be impracticable. The IPSASB noted that there are two aspects to retrospective determination: reclassification and remeasurement. The IPSASB took the view that it will usually be practicable to determine retrospectively the appropriate classification of all amounts previously included in a grantor's statement of financial position, but that retrospective remeasurement of service concession assets might not always be practicable, particularly if an entity has not previously recognized service concession assets and related liabilities, revenues, and expenses.

BC44. The IPSASB noted that, when retrospective restatement is not practicable, IPSAS 3 requires prospective application from the earliest practicable date, which could be the start of the current reporting period.

BC45. The transitional provisions in this Standard for entities that have not previously recognized service concession assets were amended from ED 43 because some respondents to ED 43 questioned why the general requirement in IPSAS 3 is not also appropriate for an entity that has not previously recognized service concession arrangements. ED 43 required prospective application in such cases, but permitted retrospective application.

BC46. When developing ED 43 the IPSASB had concerns relating to the practicality of determining the measurement of a service concession asset, and considered that this could result in inconsistent treatment of arrangements entered into in the past. This was a similar issue to that which arose in finalizing IPSAS 31, *Intangible Assets*. On that basis, the IPSASB considered it appropriate to propose transitional provisions in ED 43 that were consistent with those in IPSAS 31.

BC47. However, the IPSASB noted that the circumstances surrounding intangible assets differ from those in service concession arrangements. Notably, service concession arrangements generally involve long-term binding arrangements for which information required to develop fair value and cost information would likely be more readily available than it is for intangible assets acquired or developed in the past, even in cases where an entity had not previously recognized service concession assets.

BC48. The IPSASB did however acknowledge that because many of these arrangements may have been entered into some time ago, it may be difficult to apply full retrospective application. As a result, the IPSASB considered that a "deemed cost" could be used to recognize and measure service concession assets.

Revision of IPSAS 32 as a result of Part II of *Improvements to IPSASs 2015*: issues raised by stakeholders

BC49. The IPSASB had its attention drawn to a possible inconsistency between the requirements in IPSAS 32 and the requirements in IPSAS 17 and IPSAS 31. The requirements in IPSAS 32 could be seen as requiring service concession assets to be presented as a single class of assets, even if they were of a dissimilar nature and function. As it is not the intention of the IPSASB to require that dissimilar assets be reported as if they were similar, the IPSASB decided to propose clarifications to IPSAS 32 to make its intentions clear. The IPSASB considered whether these changes would reduce the information available to users, but is satisfied that the current disclosure requirements, in particular those in paragraph 32, ensure high quality disclosures about assets subject to service concession arrangements.

BC50. The IPSASB noted that the reclassification of service concessions assets could require a change in measurement basis for some entities. For example, some service concession assets measured using the revaluation model, might be reclassified into a class of assets measured using the cost model. Equally, some service concession assets measured using the cost model, might be reclassified into a class of assets measured using the revaluation model. Because the balance between the service concession assets and the other assets in a class will vary from entity to entity, the IPSASB agreed to permit entities to select the measurement basis to be applied at the point of reclassification. The IPSASB also noted that the information required to retrospectively apply the cost model might not be readily available. Consequently, the IPSASB agreed to permit entities to use the carrying amounts determined under the revaluation model as deemed cost at the point of reclassification where an entity elects to measure a class of assets using the cost model.

Revision of IPSAS 32 as a result of the IPSASB's *The Applicability of IPSASs*, issued in April 2016

BC51. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:

(a) Removes the standard paragraphs about the applicability of IPSASs to "public sector entities other than GBEs" from the scope section of each Standard;

(b) Replaces the term "GBE" with the term "commercial public sector entities", where appropriate; and

(c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.

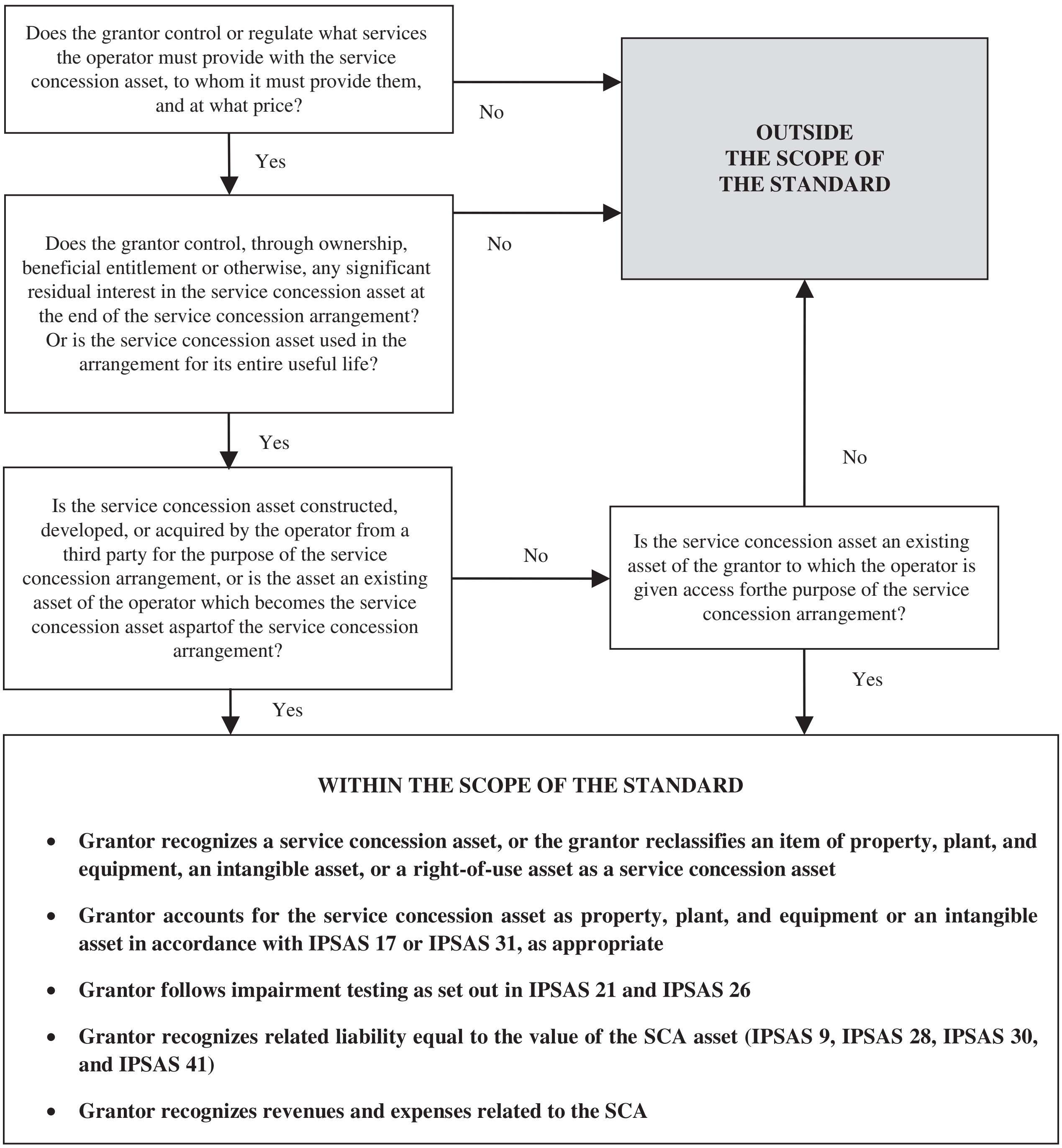
Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 32.

IG1. The purpose of this Implementation Guidance is to illustrate certain aspects of the requirements of IPSAS 32.

Accounting Framework for Service Concession Arrangements

IG2. The diagram below summarizes the accounting for service concession arrangements established by IPSAS 32.



References to IPSASs that Apply to Typical Types of Arrangements Involving an Asset Combined with Provision of a Service

IG3. The table sets out the typical types of arrangements for private sector participation in the provision of public sector services and provides references to IPSASs that apply to those arrangements. The list of arrangements types is not exhaustive. The purpose of the table is to highlight the continuum of arrangements. It is not the IPSASB's intention to convey the impression that bright lines exist between the accounting requirements for various types of arrangements.

IG4. Shaded text shows arrangements within the scope of IPSAS 32.

Category	**Lessee**	**Service provider**			**Owner**	
Typical arrangement types	Lease (e.g., operator leases asset from grantor)	Service and/or maintenance contract (specific tasks e.g., debt collection, facility management)	Rehabilitate-operate-transfer	Build-operate-transfer	Build-own-operate	100% Divestment/ Privatization/ Corporation
Asset ownership	Grantor				Operator	
Capital investment	Grantor		Operator			
Demand risk	Shared	Grantor	Grantor and/or Operator		Operator	
Typical duration	8–20 years	1–5 years	25–30 years			Indefinite (or may be limited by binding arrangement or license)
Residual interest	Grantor				Operator	
Relevant IPSASs	IPSAS 43	IPSAS 1	This IPSAS/IPSAS 17/ IPSAS 31		IPSAS 17/IPSAS 31 (derecognition) IPSAS 9 (revenue recognition)	

Illustrative Examples

These examples accompany, but are not part of, IPSAS 32.

IE1. These examples deal with only three of many possible types of service concession arrangements. Their purpose is to illustrate the accounting treatment for some features that are commonly found in practice. To make the illustrations as clear as possible, it has been assumed that the term of the service concession arrangement is only ten years and that the operator's annual receipts are constant over that period. In practice, terms may be much longer and annual revenues may increase with time.

Arrangement Terms (Common to All Three Examples)

IE2. In these examples, monetary amounts are denominated in "currency units" (CU).

IE3. These terms are common to the three examples that follow:

IE4. The terms of the arrangement require an operator to construct a road—completing construction within two years—and maintain and operate the road to a specified standard for eight years (i.e., years 3–10). The arrangement is within the scope of this Standard and the road meets the conditions for recognition of a service concession asset in paragraph 9 (or paragraph 10 for a whole-of-life asset).

IE5. The terms of the arrangement also require the operator to resurface the road when the original surface has deteriorated below a specified condition. The operator estimates that it will have to undertake the resurfacing at the end of year 8 at a fair value of CU110. The compensation to the operator for this service is included in the predetermined series of payments and/or the revenue the operator has the right to earn from the service concession asset or another revenue-generating asset granted to the operator by the grantor.

IE6. It is assumed that the original road surface is a separate component of the service concession asset and meets the criteria for recognition specified in IPSAS 17 when the service concession asset is initially recognized. It is further assumed that there is sufficient certainty regarding the timing and amount of the resurfacing work for it to be recognized as a separate component when the resurfacing occurs.[3] It is assumed that the expected cost of the resurfacing can be used to estimate the initial cost of the surface layers recognized as a separate component of the service concession asset. The road surface is therefore recognized as a separate component of the initial fair value of the service concession asset and measured at the estimated fair value of the resurfacing and depreciated over years 3–8. This depreciation period is shorter than that for the road base, and takes into account that resurfacing would ordinarily occur over six years, rather than 25 years. During the construction phase, it is assumed that only the road base is constructed in year 1, and that the road only becomes ready to use at the end of year 2.

IE7. Recognition of the replacement component of the road surface as a separate component of the service concession asset in year 8 also results in an increase in the liability recognized by the grantor. Where the liability relates to the grant of a right to the operator model, additional revenue in respect of this increase is recognized evenly over the term of the arrangement. However, if the expenditure represented an improvement in service potential such as a new traffic lane rather than restoration to original service capability then it would be appropriate to instead recognize revenue relevant to that improvement only once it has occurred.

IE8. At the beginning of year 3, the total fair value of the road is CU1,050, comprised of CU940 related to the construction of the base layers and CU110 related to construction of the surface layers. The fair value of the surface layers is used to estimate the fair value of the resurfacing (which is treated as a replacement component in accordance with IPSAS 17). The estimated life of surface layers (i.e., six years) is also used to estimate the depreciation of the replacement component in years 9 and 10. The total initial fair value of the road is lower than the present value of the series of predetermined payments pertaining to the asset, where applicable.

IE9. The road base has an economic life of 25 years. Annual depreciation is taken by the grantor on a straight-line basis. It is therefore CU38 (940/25) for the base layers. The surface layers are depreciated over 6 years (years 3–8 for the original component, and starting in year 9 for the replacement component). Annual depreciation related to the surface layers is CU18 (CU110/6). There is no impairment in the value of the road over the term of the service concession arrangement.

IE10. The operator's cost of capital is not practicable to determine. The rate implicit in the service concession arrangement specific to the asset is 6.18%.

[3] If this was not the case (e.g., where the operator might resurface in future, or might incur additional maintenance over the period of the service concession arrangement), it might not be appropriate to recognize a component.

IE11. It is assumed that all cash flows take place at the end of the year.

IE12. It is assumed that the time value of money is not significant. Paragraph AG59 provides guidance on methods that may be appropriate where the time value of money is significant.

IE13. At the end of year 10, the arrangement will end. At the end of the arrangement, the operator will transfer the operation of the road to the grantor.

IE14. The total compensation to the operator under each of the three examples is inclusive of each of the components of the service concession arrangement and reflects the fair values for each of the services, which are set out in Exhibit 1.

IE15. The grantor's accounting policy for property, plant, and equipment is to recognize such assets using the cost model specified in IPSAS 17.

Exhibit 1: Fair Values of the Components of the Arrangement (Currency Units)

Arrangement Component	Fair Value
Road – base layers	940
Road – original surface layers	110
Total FV of road	1,050
Annual service component	12
Effective interest rate	6.18%

Example 1: The Grantor makes a Predetermined Series of Payments to the Operator

Additional Terms

IE16. The terms of the arrangement require the grantor to pay the operator CU200 per year in years 3–10 for making the road available to the public. The total consideration (payment of CU200 in each of years 3–10) reflects the fair values for each of the services indicated in Exhibit 1. These payments are intended to cover the cost of constructing the road, annual operating costs of CU12 and reimbursement to the operator for the cost of resurfacing the road in year 8 of CU110.

Financial Statement Impact

IE17. The grantor initially recognizes the service concession asset as property, plant, and equipment at its fair value (total CU1,050, comprised of CU940 related to construction of the base layers and CU110 related to construction of the original surface layers). The asset is recognized as it is constructed (CU525 in year 1 and CU525 in year 2). Depreciation is taken annually (CU56, comprised of CU38 for the base layers and CU18 for the surface layers), starting from year 3.

IE18. The grantor initially recognizes a financial liability at fair value equal to the fair value of the asset under construction at the end of year 1 (CU525). The liability is increased at the end of year 2 to reflect both the fair value of the additional construction (CU525) and the finance charge on the outstanding financial liability. Because the amount of the predetermined payment related to the service component of the service concession arrangement is known, the grantor is able to determine the amount of the payment that reduces the liability. A finance charge at the implicit rate of 6.18% is recognized annually. The liability is subsequently measured at amortized cost, i.e., the amount initially recognized plus the finance charge on that amount calculated using the effective interest method minus repayments.

IE19. The compensation for the road resurfacing is included in the predetermined series of payments. There is no direct cash flow impact related to the road resurfacing; however, the grantor recognizes the resurfacing as an asset when the work is undertaken and recognizes depreciation expense of CU110/6 = CU18, beginning in year 9.

IE20. The compensation for maintenance and operating the road (CU12) is included in the predetermined series of payments. There is no cash flow impact related to this service expense; however, the grantor recognizes an expense annually.

IE21. The costs of services are accounted for in accordance with IPSAS 1.

Overview of Cash Flows, Statement of Financial Performance, and Statement of Financial Position

IE22. The grantor's cash flows, statement of financial performance, and statement of financial position over the duration of the arrangement will be as illustrated in Tables 1.1 to 1.3. In addition, Table 1.4 shows the changes in the financial liability.

Table 1.1 Cash Flows (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10	Total
Predetermined series of payments	–	–	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(1,600)
Net inflow/ (outflow)	–	–	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(1,600)

Table 1.2 Statement of Financial Performance (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10	Total
Service expense	–	–	(12)	(12)	(12)	(12)	(12)	(12)	(12)	(12)	(96)
Finance charge	–	(32)	(67)	(59)	(51)	(43)	(34)	(25)	(22)	(11)	(344)
Depreciation – base layers	–	–	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(304)
Depreciation – original surface layer	–	–	(18)	(19)	(18)	(18)	(19)	(18)	–	–	(110)
Depreciation – replacement surface layer	–	–	–	–	–	–	–	–	(18)	(19)	(37)
Total depreciation	–	–	(56)	(57)	(56)	(56)	(57)	(56)	(56)	(57)	(451)
Annual surplus/ (deficit)	–	(32)	(135)	(128)	(119)	(111)	(103)	(93)	(90)	(80)	(891)

NOTES:

1. Depreciation in years 3–8 reflects the depreciation on the initially-constructed road surface. It is fully depreciated over that period. Depreciation in years 9–10 reflects the depreciation on the new service concession asset component (surface) recognized in year 8.
2. Although these Illustrative Examples use a straight-line depreciation method, it is not intended that this method be used in all cases. Paragraph 76 of IPSAS 17 requires that, "The depreciation method shall reflect the pattern in which the asset's future economic benefits or service potential is expected to be consumed by the entity." Likewise, for intangible assets, paragraph 96 of IPSAS 31 requires that, "The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life."

Table 1.3 Statement of Financial Position (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Service concession asset – base layers	525	940	902	864	826	788	750	712	674	636
Service concession asset – original surface layer	–	110	92	73	55	37	18	–	–	–
Service concession asset – replacement surface layer	–	–	–	–	–	–	–	110	92	73
Total Service concession asset	525	1,050	994	937	881	825	768	822	766	709
Cash	–	–	(200)	(400)	(600)	(800)	(1,000)	(1,200)	(1,400)	(1,600)
Financial liability	(525)	(1,082)	(961)	(832)	(695)	(550)	(396)	(343)	(177)	–
Cumulative surplus/deficit	–	32	167	295	414	525	628	721	811	891

NOTES:

1. In this example, the resurfacing occurs as expected in year 8, when the initially-constructed road surface is fully depreciated. If the resurfacing occurred earlier, the initially-constructed road surface would not be fully depreciated, and would need to be derecognized in accordance with IPSAS 17 before the new component of the service concession asset related to the resurfacing is recognized.
2. The new component of the service concession asset related to the resurfacing is recognized in year 8. Years 9–10 reflect deprecation on this additional component (Table 1.2).
3. The financial liability is increased in year 8 for the recognition of the new component of the service concession asset.

Table 1.4 Changes in Financial Liability (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	525	1,082	961	832	695	550	396	343	177
Liability recognized along with initial service concession asset	525	525	–	–	–	–	–	–	–	–
Finance charge added to liability prior to payments being made	–	32	–	–	–	–	–	–	–	–
Portion of predetermined series of payments that reduces the liability	–	–	(121)	(129)	(137)	(145)	(154)	(163)	(166)	(177)
Liability recognized along with replacement surface layers	–	–	–	–	–	–	–	110	–	–
Balance carried forward	525	1,082	961	832	695	550	396	343	177	–

Example 2: The Grantor Gives the Operator the Right to Charge Users a Toll for Use of the Road

Additional Arrangement Terms

IE23. The terms of the arrangement allow the operator to collect tolls from drivers using the road. The operator forecasts that vehicle numbers will remain constant over the duration of the arrangement and that it will receive tolls of CU200 in each of years 3–10. The total consideration (tolls of CU200 in each of years 3–10) reflects the fair values for each of the services indicated in Exhibit 1, and is intended to cover the cost of constructing the road, annual operating costs of CU12 and reimbursement to the operator for the cost of resurfacing the road in year 8 of CU110.

Financial Statement Impact

IE24. The grantor initially recognizes the service concession asset as property, plant, and equipment at its fair value (total CU1,050, comprised of CU940 related to construction of the base layers and CU110 related to construction of the original surface layers). The asset is recognized as it is constructed (CU525 in year 1 and CU525 in year 2). Depreciation is taken annually (CU56, comprised of CU38 for the base layers and CU18 for the surface layers, starting in year 3).

IE25. As consideration for the service concession asset, the grantor recognizes a liability under the grant of a right to the operator model for granting the operator the right to collect tolls of CU200 in years 3–10. The liability is recognized as the asset is recognized.

IE26. The liability is reduced over years 3–10, and the grantor recognizes revenue on that basis because access to the service concession asset is expected to be provided evenly over the term of the service concession arrangement from the point at which the asset is capable of providing economic benefits.

IE27. The compensation for the road resurfacing is included in the tolls the operator expects to earn over the term of the service concession arrangement. There is no direct cash flow impact related to the road resurfacing; however, the grantor recognizes the resurfacing as an asset when the work is undertaken and recognizes depreciation expense of CU110/6 = CU18, beginning in year 9.

IE28. The compensation for maintenance and operating the road (CU12) is included in the tolls the operator expects to earn over the term of the service concession arrangement. There is no financial statement impact related to this service expense. It does not affect cash flow because the grantor has no cash outflow. It is not recognized as an operating expense because the fair value of the asset and liability initially recognized do not include any service costs the operator may incur.

Overview of Cash Flows, Statement of Financial Performance, and Statement of Financial Position

IE29. The grantor's cash flows, statement of financial performance, and statement of financial position over the duration of the arrangement will be as illustrated in Tables 2.1 to 2.2. In addition, Table 2.3 shows the changes in the liability.

Cash Flows

IE30. Because there are no payments made to the operator, there are no cash flow impacts for this example.

Table 2.1 Statement of Financial Performance (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue (reduction of liability)	–	–	145	145	145	145	145	145	145	145	1160
Depreciation – base layers	–	–	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(304)
Depreciation – original surface layer	–	–	(18)	(19)	(18)	(18)	(19)	(18)	–	–	(110)
Depreciation – replacement surface layer	–	–	–	–	–	–	–	–	(18)	(19)	(37)
Total depreciation	–	–	(56)	(57)	(56)	(56)	(57)	(56)	(56)	(57)	(451)
Annual surplus/(deficit)	–	–	89	88	89	89	88	89	89	88	709

NOTES:

1. Depreciation in years 3–8 reflects the depreciation on the initially-constructed road surface. It is fully depreciated over that period.
2. Depreciation in years 9–10 reflects the depreciation on the new service concession asset component (surface) recognized in year 8.
3. The revenue (reduction of the liability) includes revenue from the additional liability (Table 2.3).
4. All revenue is recognized evenly over the term of the arrangement.

Table 2.2 Statement of Financial Position (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Service concession asset – base layers	525	940	902	864	826	788	750	712	674	636
Service concession asset – original surface layer	–	110	92	73	55	37	18	–	–	–
Service concession asset – replacement surface layer	–	–	–	–	–	–	–	110	92	73
Total Service concession asset	525	1,050	994	937	881	825	768	822	766	709
Cash	–	–	–	–	–	–	–	–	–	–
Liability	(525)	(1,050)	(905)	(760)	(615)	(470)	(325)	(290)	(145)	–
Cumulative surplus/deficit	–	–	(89)	(177)	(266)	(355)	(443)	(532)	(621)	(709)

NOTES:

1. In this example, the resurfacing occurs as expected in year 8, when the initially-constructed road surface is fully depreciated. If the resurfacing occurred earlier, the initially-constructed road surface would not be fully depreciated, and would need to be derecognized in accordance with IPSAS 17 before the new component of the service concession asset related to the resurfacing is recognized.
2. The new component of the service concession asset related to the resurfacing is recognized in year 8. Years 9–10 reflect deprecation on this additional component (Table 2.2).
3. The liability is increased in year 8 for the recognition of the new component of the service concession asset.

Table 2.3 Changes in Liability (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	525	1,050	905	760	615	470	325	290	145
Liability recognized along with initial service concession asset	525	525	–	–	–	–	–	–	–	–
Revenue (reduction of liability)	–	–	(145)	(145)	(145)	(145)	(145)	(145)	(145)	(145)
Liability recognized along with replacement surface layers	–	–	–	–	–	–	–	110	–	–
Balance carried forward	525	1,050	905	760	615	470	325	290	145	–

Example 3: The Grantor Makes a Predetermined Series of Payments to the Operator and Also Grants the Operator the Right to Charge Users a Toll for Use of the Road

Additional Arrangement Terms

IE31. The terms of the arrangement allow the operator to collect tolls from drivers using the road. The operator forecasts that vehicle numbers will remain constant over the duration of the arrangement and that it will receive tolls of CU100 in each of years 3–10. The arrangement also requires the grantor to make a predetermined series of payments to the operator of CU100 annually. The fair value of the right to collect tolls and the predetermined series of payments are considered to compensate the operator equally (i.e., 50% from each form of compensation to the operator).

Financial Statement Impact

IE32. The grantor initially recognizes the service concession asset as property, plant, and equipment at its fair value (total CU1,050, comprised of CU940 related to construction of the base layers and CU110 related to construction of the original surface layers). The asset is recognized as it is constructed (CU525 in year 1 and CU525 in year 2). Depreciation is taken annually (CU56, comprised of CU38 for the base layers and CU18 for the surface layers).

IE33. As consideration for the service concession asset, the grantor recognizes both a liability under the grant of a right to the operator model by granting the operator the right to collect tolls of CU100 in years 3–10, and a financial liability to make payments of CU100 in years 3–10. A liability and a financial liability are recognized as the asset is recognized at the end of year 1 (CU525). The liability and financial liability are increased at the end of year 2 to reflect both the fair value of the additional construction (CU525) and the finance charge on the outstanding financial liability.

IE34. The grantor's obligation related to the right granted to the operator to charge tolls and the predetermined payments are regarded as two separate items. Therefore in this arrangement it is necessary to divide the grantor's consideration to the operator into two parts—a liability and a financial liability.

IE35. The liability of CU525 (recognized evenly at the end of years 1 and 2) is reduced over years 3–10, and the grantor recognizes revenue on the same basis because the tolls are expected to be earned evenly over the term of the service concession arrangement from the point at which the asset is capable of providing service benefits.

IE36. The grantor initially recognizes a financial liability at fair value equal to half of the fair value of the asset (CU525), recognized evenly at the end of years 1 and 2; a liability under the grant of a right to the operator model is recognized in an amount equal to the other half of the fair value of the asset. The financial liability is also increased at the end of year 2 by the finance charge on the outstanding financial liability. Because the amount of the predetermined payments related to the service component of the service concession arrangement is known, the grantor is able to determine the amount of the payments that reduces the liability. A finance charge at the implicit rate of 6.18% is recognized annually. The liability is subsequently measured at amortized cost, i.e., the amount initially recognized plus the finance charge on that amount calculated using the effective interest method minus repayments.

IE37. The operator is compensated for the road resurfacing (CU110) equally through the tolls the operator expects to earn over the term of the service concession arrangement and the series of predetermined payments (i.e., 50% from each). There is no direct cash flow impact related to the road resurfacing; however, the grantor recognizes the resurfacing as an asset when the work is undertaken and recognizes depreciation expense of CU110/6 = CU18, beginning in year 9.

IE38. The operator is compensated for maintenance and operating the road (CU12) equally through the tolls the operator expects to earn over the term of the service concession arrangement and the predetermined payment (i.e., 50% from each). There is no direct cash flow impact related to this service expense because the grantor has no cash outflow. However, the grantor recognizes an expense annually for the portion of the compensation related to the series of predetermined payments (CU6). There is no financial statement impact for the remaining CU6 of this service expense. It is not recognized as an operating expense because the fair value of the asset and liability initially recognized do not include any service costs the operator may incur.

IE39. The grantor's cash flows, statement of financial performance, and statement of financial position over the duration of the arrangement will be as illustrated in Tables 3.1 to 3.3. In addition, Table 3.4 shows the changes in the liability and Table 3.5 shows the changes in the financial liability.

Overview of Cash Flows, Statement of Financial Performance, and Statement of Financial Position

Table 3.1 Cash Flows (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10	Total
Predetermined series of payments	–	–	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(800)
Net inflow/ (outflow)	–	–	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(800)

Table 3.2 Statement of Financial Performance (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue (reduction of liability)	–	–	73	72	73	72	73	72	73	72	580
Service expense	–	–	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(48)
Finance charge	–	(16)	(33)	(30)	(26)	(22)	(17)	(12)	(11)	(5)	(172)
Depreciation – base layers	–	–	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(304)
Depreciation – original surface layer	–	–	(18)	(19)	(18)	(18)	(19)	(18)	–	–	(110)
Depreciation – replacement surface layer	–	–	–	–	–	–	–	–	(18)	(19)	(37)
Total depreciation	–	–	(56)	(57)	(56)	(56)	(57)	(56)	(56)	(57)	(451)
Annual surplus/(deficit)	–	(16)	(22)	(21)	(15)	(12)	(7)	(2)	–	4	(91)

NOTES:

1. Depreciation in years 3–8 reflects the depreciation on the initially-constructed road surface. It is fully depreciated over that period.
2. Depreciation in years 9–10 reflects the depreciation on the new service concession asset component (surface) recognized in year 8.
3. The revenue (reduction of the liability) includes revenue from the additional liability (Table 3.3).
4. All revenue is recognized evenly over the term of the arrangement.

Table 3.3 Statement of Financial Position (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Service concession asset – base layers	525	940	902	864	826	788	750	712	674	636
Service concession asset – surface layer	–	110	92	73	55	37	18	–	–	–
Service concession asset – replacement surface layer	–	–	–	–	–	–	–	110	92	73
Total service concession asset	525	1,050	994	937	881	825	768	822	766	709
Cash	–	–	(100)	(200)	(300)	(400)	(500)	(600)	(700)	(800)
Liability	(262)	(525)	(452)	(380)	(307)	(235)	(162)	(145)	(72)	–
Financial liability	(263)	(541)	(480)	(416)	(348)	(276)	(199)	(172)	(89)	–
Cumulative surplus/deficit	–	16	38	59	74	86	93	95	95	91

NOTES:

1. In this example, the resurfacing occurs as expected in year 8, when the initially-constructed road surface is fully depreciated. If the resurfacing occurred earlier, the initially-constructed road surface would not be fully depreciated, and would need to be derecognized in accordance with IPSAS 17 before the new component of the service concession asset related to the resurfacing is recognized.
2. The new component of the service concession asset related to the resurfacing is recognized in year 8. Years 9–10 reflect deprecation on this additional component (Table 3.2).
3. The liability is increased in year 8 for the recognition of 50% of the new component of the service concession asset.
4. The financial liability is increased in year 8 for the recognition of 50% of the new component of the service concession asset.

Table 3.4 Changes in Liability (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	262	525	452	380	307	235	162	145	72
Liability recognized along with initial service concession asset	262	263	–	–	–	–	–	–	–	–
Revenue (reduction of liability)	–	–	(73)	(72)	(73)	(72)	(73)	(72)	(73)	(72)
Liability recognized along with replacement surface layers	–	–	–	–	–	–	–	55	–	–
Balance carried forward	262	525	452	380	307	235	162	145	72	–

Table 3.5 Changes in Financial Liability (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	263	541	480	416	348	276	199	172	89
Liability recognized along with initial service concession asset	263	262	–	–	–	–	–	–	–	–
Finance charge added to liability prior to payments being made	–	16	–	–	–	–	–	–	–	–
Portion of predetermined series of payments that reduces the liability	–	–	(61)	(64)	(68)	(72)	(77)	(82)	(83)	(89)
Liability recognized along with replacement surface layers	–	–	–	–	–	–	–	55	–	–
Balance carried forward	263	541	480	416	348	276	199	172	89	–

IPSAS 33—FIRST-TIME ADOPTION OF ACCRUAL BASIS INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS (IPSASS)

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* was issued in January 2015.

Since then, IPSAS 33 has been amended by the following IPSASs:

- IPSAS 43, *Leases* (issued January 2022)
- *Improvements to IPSAS 2021* (issued January 2022)
- *COVID-19: Deferral of Effective Dates* (issued November 2020)
- *Improvements to IPSAS 2019* (issued January 2020)
- IPSAS 42, *Social Benefits* (issued January 2019)
- *Improvements to IPSAS 2018* (issued October 2018)
- IPSAS 41, *Financial Instruments* (issued August 2018)
- IPSAS 40, *Public Sector Combinations* (issued January 2017)
- IPSAS 39, *Employee Benefits* (issued July 2016)
- *The Applicability of IPSASs* (issued April 2016)
- *Improvements to IPSASs 2015* (issued April 2016)

Table of Amended Paragraphs in IPSAS 33

Paragraph Affected	How Affected	Affected By
7	Deleted	The Applicability of IPSASs April 2016
8	Deleted	The Applicability of IPSASs April 2016
36	Amended	IPSAS 39 July 2016 IPSAS 41 August 2018 IPSAS 42 January 2019 IPSAS 43 January 2022
39	Amended	Improvements to IPSASs April 2016
Heading above paragraph 46	Amended	IPSAS 43 January 2022
46	Amended	IPSAS 43 January 2022
47	Amended	IPSAS 43 January 2022
62A	New	IPSAS 40 January 2017
62B	New	IPSAS 40 January 2017
62C	New	IPSAS 40 January 2017
64	Amended	IPSAS 41 August 2018 IPSAS 43 January 2022
72	Amended	IPSAS 41 August 2018

Paragraph Affected	How Affected	Affected By
78	Amended	Improvements to IPSAS October 2018
79	Amended	Improvements to IPSAS October 2018
85A	New	Improvements to IPSAS October 2018
85B	New	Improvements to IPSAS January 2022
86	Amended	IPSAS 40 January 2017
Heading above paragraph 95	Amended	IPSAS 43 January 2022
95	Amended	IPSAS 43 January 2022
96	Deleted	IPSAS 43 January 2022
96A	New	IPSAS 43 January 2022
96B	New	IPSAS 43 January 2022
96C	New	IPSAS 43 January 2022
96D	New	IPSAS 43 January 2022
102	Amended	IPSAS 39 July 2016
104	Amended	IPSAS 39 July 2016
105	Amended	IPSAS 39 July 2016
106	Deleted	IPSAS 39 July 2016
107	Deleted	IPSAS 39 July 2016
Heading above paragraph 113	Amended	IPSAS 41 August 2018
113	Amended	Improvements to IPSAS January 2020 IPSAS 41 August 2018
113A	New	Improvements to IPSAS January 2020
114	Deleted	Improvements to IPSAS January 2020
114A	New	IPSAS 41 August 2018
115	Amended	IPSAS 41 August 2018
116	Amended	IPSAS 41 August 2018
117	Amended	IPSAS 41 August 2018
118	Amended	IPSAS 41 August 2018
119	Amended	IPSAS 41 August 2018
119A	New	IPSAS 41 August 2018
119B	New	IPSAS 41 August 2018
119C	New	IPSAS 41 August 2018
119D	New	IPSAS 41 August 2018
120	Amended	IPSAS 41 August 2018
122	Amended	IPSAS 41 August 2018
122A	New	IPSAS 41 August 2018

Paragraph Affected	How Affected	Affected By
122B	New	IPSAS 41 August 2018
122C	New	IPSAS 41 August 2018
Heading above paragraph 122D	New	IPSAS 41 August 2018
122D	New	IPSAS 41 August 2018
123	Amended	Improvements to IPSAS October 2018
124	Amended	IPSAS 41 August 2018
129	Amended	IPSAS 40 January 2017
130	Amended	IPSAS 40 January 2017
132	Amended	IPSAS 40 January 2017
Heading above paragraph 134A	New	IPSAS 42 January 2019
134A	New	IPSAS 42 January 2019
134B	New	IPSAS 42 January 2019
142	Amended	Improvements to IPSAS October 2018
Heading above paragraph 148	Amended	IPSAS 43 January 2022
148	Amended	IPSAS 43 January 2022
154A	New	The Applicability of IPSASs April 2016
154B	New	IPSAS 39 July 2016
154C	New	IPSAS 40 January 2017
154D	Amended	COVID-19: Deferral of Effective Dates November 2020
154E	New	Improvements to IPSAS October 2018
154F	New	Improvements to IPSAS October 2018
154G	Amended	COVID-19: Deferral of Effective Dates November 2020
154H	Amended	COVID-19: Deferral of Effective Dates November 2020
154I	New	Improvements to IPSAS January 2022
154J	New	IPSAS 43 January 2022
BC126	New	Improvements to IPSAS January 2022
IG20	Amended	IPSAS 43 January 2022
IG21	Amended	IPSAS 43 January 2022
IG29	Amended	Improvements to IPSAS October 2018
IG35	Amended	Improvements to IPSAS October 2018
IG39	Amended	Improvements to IPSAS January 2020
IG51	Amended	IPSAS 43 January 2022
Heading above paragraph IG52	Amended	IPSAS 43 January 2022

Paragraph Affected	How Affected	Affected By
IG52	Amended	IPSAS 43 January 2022
Heading above paragraph IG67	Amended	IPSAS 41 August 2018
IG67	Amended	IPSAS 41 August 2018
IG68	Amended	IPSAS 41 August 2018
IG69	Amended	IPSAS 41 August 2018
IG70	Amended	IPSAS 41 August 2018
IG71	Amended	IPSAS 41 August 2018
IG74	Amended	IPSAS 41 August 2018
IG91	Amended	IPSAS 41 August 2018 Improvements to IPSAS October 2018 IPSAS 42 January 2019 IPSAS 43 January 2022
Appendix	Amended	IPSAS 41 August 2018

IPSAS 33—FIRST-TIME ADOPTION OF ACCRUAL BASIS INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS (IPSASs)

CONTENTS

International Public Sector Accounting Standard 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* is set out in paragraphs 1–154. All the paragraphs have equal authority. IPSAS 33 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to provide guidance to a first-time adopter that prepares and presents financial statements following the adoption of accrual basis IPSASs, in order to present high quality information:

   (a) That provides transparent reporting about a first-time adopter's transition to accrual basis IPSASs;

   (b) That provides a suitable starting point for accounting in accordance with accrual basis IPSASs irrespective of the basis of accounting the first-time adopter has used prior to the date of adoption; and

   (c) Where the benefits are expected to exceed the costs.

Scope

2. **An entity shall apply this IPSAS when it prepares and presents its annual financial statements on the adoption of, and during the transition to, accrual basis IPSASs.**

3. This IPSAS applies when an entity first adopts accrual basis IPSASs and during the transitional period allowed in this IPSAS. It does not apply when, for example, a first-time adopter:

   (a) Stops presenting financial statements in accordance with prescribed requirements, having previously presented them as well as another set of financial statements that contained an explicit and unreserved statement of compliance with accrual basis IPSASs;

   (b) Presented financial statements in the previous reporting period in accordance with prescribed requirements and those financial statements contained an explicit and unreserved statement of compliance with accrual basis IPSASs; or

   (c) Presented financial statements in the previous reporting period that contained an explicit and unreserved statement of compliance with accrual basis IPSASs, even if the auditors modified their audit report on those financial statements.

4. This Standard shall be applied from the date on which a first-time adopter adopts accrual basis IPSASs and during the period of transition. This Standard permits a first-time adopter to apply transitional exemptions and provisions that may impact fair presentation. Where these transitional exemptions and provisions are applied, a first-time adopter is required to disclose information about the transitional exemptions and provisions adopted, and progress towards fair presentation and compliance with accrual basis IPSASs.

5. At the end of the transitional period a first-time adopter must comply with the recognition, measurement, presentation and disclosure requirements in the other accrual basis IPSAS in order to assert compliance with accrual basis IPSASs as required in IPSAS 1, *Presentation of Financial Statements*.

6. This IPSAS does not apply to changes in accounting policies made by an entity that already applies IPSASs. Such changes are the subject of:

   (a) Requirements on changes in accounting policies in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*; and

   (b) Specific transitional requirements in other IPSASs. The transitional provisions in other IPSASs apply only to changes in accounting policies made by an entity that already applies accrual basis IPSASs; they do not apply to a first-time adopter's transition to IPSASs, except as specified in this IPSAS.

7. [Deleted]

8. [Deleted]

Definitions

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

   <u>Date of adoption of IPSASs</u> is the date an entity adopts accrual basis IPSASs for the first time, and is the start of the reporting period in which the first-time adopter adopts accrual basis IPSASs and for which the entity presents its first transitional IPSAS financial statements or its first IPSAS financial statements.

   <u>Deemed cost</u> is an amount used as a surrogate for acquisition cost or depreciated cost at a given date.

   <u>First IPSAS financial statements</u> are the first annual financial statements in which an entity complies with the accrual basis IPSASs and can make an explicit and unreserved statement of compliance with those IPSASs because

it adopted one or more of the transitional exemptions in this IPSAS that do not affect the fair presentation of the financial statements and its ability to assert compliance with accrual basis IPSASs.

First-time adopter is an entity that adopts accrual basis IPSASs for the first time and presents its first transitional IPSAS financial statements or its first IPSAS financial statements.

Opening statement of financial position is a first-time adopter's statement of financial position at the date of adoption of IPSASs.

Period of transition is the period during which a first-time adopter applies one or more of the exemptions in this IPSAS before it complies with the accrual basis IPSASs, and before it is able to make an explicit and unreserved statement of such compliance with IPSASs.

Previous basis of accounting is the basis of accounting that a first-time adopter used immediately before adopting accrual basis IPSASs.

Transitional IPSAS financial statements are the financial statements prepared in accordance with this IPSAS where a first-time adopter cannot make an explicit and unreserved statement of compliance with other IPSASs because it adopted one or more of the transitional exemptions in this IPSAS that affect the fair presentation of the financial statements and its ability to assert compliance with accrual basis IPSASs.

Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.

Date of Adoption of IPSASs

10. The date of adoption of IPSASs is the date that an entity adopts accrual basis IPSASs for the first time. It is the start of the reporting period in which the first-time adopter adopts accrual basis IPSASs and for which it presents its first transitional IPSAS financial statements or its first IPSAS financial statements. If a first-time adopter takes advantage of the exemptions in this IPSASs that affect fair presentation and compliance with accrual basis IPSASs (see paragraphs 36–62) in producing its first transitional IPSAS financial statements, it can only make an explicit and unreserved statement of compliance with accrual basis IPSASs when the exemptions that provided the relief have expired, and/or when the relevant items are recognized, measured and/or the relevant information is presented and/or disclosed in the financial statements in accordance with the applicable IPSASs (whichever is earlier). Financial statements shall not be described as complying with IPSASs unless they comply with all the requirements of all the applicable IPSASs.

First IPSAS Financial Statements

11. An entity's first IPSAS financial statements are the first annual financial statements in which the first-time adopter can make an explicit and unreserved statement in those financial statements of compliance with accrual basis IPSASs. If a first-time adopter does not adopt the exemptions in this IPSAS that affect fair presentation and compliance with accrual basis IPSASs (see paragraphs 36–62), its first financial statements following the adoption of accrual basis IPSASs will also be its first IPSAS financial statements.

Previous Basis of Accounting

12. The previous basis of accounting is the basis of accounting that a first-time adopter used immediately before adopting accrual basis IPSASs. This might be a cash basis of accounting, an accrual basis of accounting, a modified version of either a cash basis or an accrual basis of accounting, or another prescribed basis.

Transitional IPSAS Financial Statements

13. An entity's transitional IPSAS financial statements are the annual financial statements in which an entity transitions to accrual basis IPSASs and adopts certain exemptions in this IPSAS that affect the fair presentation of the financial statements and its ability to assert compliance with accrual basis IPSASs. If a first-time adopter adopts the exemptions in this IPSASs that affect fair presentation and compliance with accrual basis IPSASs (see paragraphs 36–62), it will not be able to make an explicit and unreserved statement of compliance with other accrual basis IPSASs until the exemptions that provided the relief in this IPSAS have expired and/or when the relevant items are recognized, measured and/or the relevant information has been presented and/or disclosed in accordance with the applicable IPSASs (whichever is earlier). Financial statements shall not be described as complying with IPSASs unless they comply with all the requirements of all the applicable IPSASs.

14. An entity's transitional IPSAS financial statements are those financial statements, where the entity transitions from another accounting basis such as when it:

(a) Prepared its most recent previous financial statements in accordance with the IPSAS, *Financial Reporting Under the Cash Basis of Accounting*;

(b) Presented its most recent previous financial statements:

(i) In accordance with prescribed requirements that are not consistent with IPSASs in all respects;

(ii) In conformity with IPSASs in all respects, except that the financial statements did not contain an explicit and unreserved statement that they complied with IPSASs;

(iii) Containing an explicit statement of compliance with some, but not all, IPSASs, including the adoption of the exemptions provided in this IPSAS that affect fair presentation and compliance with accrual basis IPSASs (see paragraphs 36–62);

(iv) In accordance with prescribed requirements inconsistent with IPSASs, using some individual IPSASs to account for items for which prescribed requirements did not exist; or

(v) In accordance with prescribed requirements, with a reconciliation of some amounts to the amounts determined in accordance with IPSASs;

(c) Prepared financial statements in accordance with IPSASs for internal use only, without making them available to external users;

(d) Prepared a reporting package in accordance with IPSASs for consolidation purposes without preparing a complete set of financial statements as defined in IPSAS 1; or

(e) Did not present financial statements for previous periods.

Recognition and Measurement

Opening Statement of Financial Position on Adoption of IPSASs

15. **A first-time adopter shall prepare and present an opening statement of financial position at the date of adoption of IPSASs. This is the starting point for its accounting in accordance with accrual basis IPSASs.**

Accounting Policies

16. **On the date of adoption of accrual basis IPSASs, a first-time adopter shall apply the requirements of the IPSASs retrospectively except if required, or otherwise permitted, in this IPSAS.**

17. **A first-time adopter shall use the same accounting policies in its opening statement of financial position and throughout all periods presented, except as specified in paragraphs 36–134. The accounting policies shall comply with each IPSAS effective at the date of adoption of IPSASs, except as specified in paragraphs 36–134.**

18. A first-time adopter that takes advantage of the exemptions in paragraph 36–134 will be required to amend its accounting policies after the exemptions that provided the relief have expired and/or when the relevant items are recognized, measured and/or the relevant information is presented and/or disclosed in the financial statements in accordance with the applicable IPSASs (whichever is earlier).

19. A first-time adopter shall apply the versions of accrual basis IPSASs effective at the date of adoption of IPSASs. A first-time adopter may apply a new IPSAS that is not yet mandatory if that IPSAS permits early application. Any new IPSASs that become effective during the period of transition shall be applied by the first-time adopter from the date it becomes effective.

20. Except as described in paragraphs 36–134, a first-time adopter shall, in its opening statement of financial position:

(a) Recognize all assets and liabilities whose recognition is required by IPSASs;

(b) Not recognize items as assets or liabilities if IPSASs do not permit such recognition;

(c) Reclassify items that it recognized in accordance with the previous basis of accounting as one type of asset, liability or component of net assets/equity, but are a different type of asset, liability or component of net assets/equity in accordance with IPSASs; and

(d) Apply IPSASs in measuring all recognized assets and liabilities.

21. The accounting policies that a first-time adopter uses in financial statements may differ from those that it used at the end of its comparative period under its previous basis of accounting. The resulting adjustments arise from transactions,

other events or conditions before the date of adoption of IPSASs. Therefore, a first-time adopter shall recognize those adjustments to the opening balance of accumulated surplus or deficit in the period in which the items are recognized and/or measured (or, if appropriate, another category of net assets/equity). The first-time adopter shall recognize these adjustments in the earliest period presented.

22. The transitional exemptions and provisions in other IPSAS apply to changes in accounting policies made by an entity that already applies accrual basis IPSASs. The transitional exemptions and provisions in this IPSAS applies to a first-time adopter that prepares and presents its annual financial statements on the adoption of, and during the transition to accrual basis IPSASs.

Exceptions to the Retrospective Application of IPSASs

23. **A first-time adopter's estimates in accordance with IPSASs at the date of adoption of IPSASs, shall be consistent with estimates made in accordance with the previous basis of accounting (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were inconsistent with the requirements in IPSASs.**

24. This IPSAS prohibits retrospective application of some aspects of accrual basis IPSASs. A first-time adopter may receive information after the date of adoption of IPSASs about estimates that it had made under its previous basis of accounting. In accordance with paragraph 23, a first-time adopter shall treat the receipt of that information in the same way as non-adjusting events after the reporting period in accordance with IPSAS 14, *Events after the Reporting Period.*

25. A first-time adopter may need to make estimates in accordance with IPSASs at the date of adoption of IPSASs or during the period of transition that were not required at that date under the previous basis of accounting. To achieve consistency with IPSAS 14, those estimates in accordance with IPSASs shall reflect conditions that existed at the date of adoption of IPSASs or at the date during the period of transition. In particular, estimates determined at the date of adoption of IPSASs or during the period of transition of market prices, interest rates or foreign exchange rates shall reflect market conditions at that date. For non-financial assets, such as property, plant and equipment, estimates about the asset's useful life, residual value or condition reflect management's expectations and judgment at the date of adoption of IPSASs or the date during the period of transition.

26. Paragraphs 23–25 apply to the opening statement of financial position. They also apply to a comparative period where an entity elects to present comparative information in accordance with paragraph 78, in which case the references to the date of adoption of IPSASs are replaced by references to the end of that comparative period.

Fair Presentation and Compliance with IPSASs

27. **A first-time adopter's first IPSAS financial statements shall fairly present the financial position, financial performance, and cash flows of the entity. Fair presentation requires the faithful representation of the effects of transactions, other events, and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue, and expenses set out in IPSASs. If a first-time adopter takes advantage of the exemptions in paragraphs 36–62, these exemptions will affect the fair presentation of the financial statements and the first-time adopter's ability to assert compliance with accrual basis IPSASs, until the exemptions that provided the relief have expired and/or when the relevant items are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier).**

28. **A first-time adopter shall claim full compliance with IPSASs only when it has complied with all the requirements of the applicable IPSASs effective at that date, subject to paragraph 11. If a first-time adopter adopts one or more of the exemptions in paragraph 36–62, the fair presentation of the financial statements and its ability to assert compliance with accrual basis IPSASs will be affected. An entity's whose financial statements comply with IPSASs shall make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with IPSASs unless they comply with all the requirements of IPSASs, and shall be qualified as accrual basis IPSAS complaint financial statements.**

29. In accordance with paragraph 29 of IPSAS 1 fair presentation is achieved in virtually all circumstances by compliance with applicable IPSASs. For a first-time adopter to claim full compliance with IPSASs, all the requirements of the applicable IPSASs needs to be complied with to ensure that information is presented in a manner that meets the qualitative characteristics, subject to paragraph 11.

30. The exemptions in paragraphs 36–62 provide relief from the recognition, measurement, presentation and/or disclosure requirements in IPSASs on the date of adoption of IPSASs and during the period of transition. A first-time adopter may elect to adopt these exemptions, but shall consider that applying these exemptions will affect the fair presentation of its financial

statements and its ability to assert compliance with accrual basis IPSASs in accordance with paragraphs 27 and 28 until the exemptions that provided the relief have expired and/or when the relevant items are recognized, measured, and/or the relevant information is presented and/or disclosed in the financial statements in accordance with the applicable IPSASs (whichever is earlier). Before making use of such exemptions, a first-time adopter shall consider all the relevant facts and circumstances and the potential effect on its financial statements.

31. **A first-time adopter shall assess whether the transitional exemptions adopted affect the fair presentation of the financial statements and the first-time adopter's ability to assert compliance with accrual basis IPSASs.**

32. For example, a first-time adopter adopts the three year transitional relief period for the recognition and measurement of traffic fines because insufficient data is available about the value of fines issued, fines written off, the compromises reached with offenders etc. The relief period is not applied to any other class of non-exchange revenue. The revenue received from fines is not material in relation to the financial statements as a whole. The entity concludes that, by adopting the transitional exemption and provisions, fair presentation and compliance with IPSASs will not be affected. As a result, the first-time adopter will still be able to achieve fair presentation and assert compliance with accrual basis IPSASs at the date of adoption of accrual basis IPSASs or during the period of transition.

Exemptions that Affect Fair Presentation and Compliance with Accrual Basis IPSASs during the Period of Transition

33. **A first-time adopter may adopt the exemptions in paragraphs 36–62. These exemptions will affect the fair presentation of a first-time adopter's financial statements and its ability to assert compliance with accrual basis IPSASs during the period of transition in accordance with paragraphs 27 and 28 while they are applied. A first-time adopter shall not apply these exemptions by analogy to other items.**

34. **Notwithstanding the exemptions provided in paragraphs 36–62 a first-time adopter is encouraged to comply in full with all the requirements of the applicable IPSASs as soon as possible.**

35. **To the extent that a first-time adopter applies the exemptions in paragraph 36–62, it is not required to apply any associated presentation and/or disclosure requirements in the applicable IPSASs until the exemptions that provided the relief have expired or the relevant items are recognized and/or measured in the financial statements in accordance with the applicable IPSASs (whichever is earlier).**

Three Year Transitional Relief Period for the Recognition and/or Measurement of Assets and/or Liabilities

Recognition and/or Measurement of Assets and/or Liabilities

36. **Where a first-time adopter has not recognized assets and/or liabilities under its previous basis of accounting, it is not required to recognize and/or measure the following assets and/or liabilities for reporting periods beginning on a date within three years following the date of adoption of IPSASs:**

    (a) **Inventories (see IPSAS 12, *Inventories*);**

    (b) **Investment property (see IPSAS 16, *Investment Property*);**

    (c) **Property, plant and equipment (see IPSAS 17, *Property, Plant and Equipment*);**

    (d) **Defined benefit plans and other long-term employee benefits (see IPSAS 39, *Employee Benefits*);**

    (e) **Biological assets and agricultural produce (see IPSAS 27, *Agriculture*);**

    (f) **Intangible assets (see IPSAS 31, *Intangible Assets*);**

    (fa) **Right-of-use assets and the related lease liabilities (see IPSAS 43, *Leases*);**

    (g) **Service concession assets and the related liabilities, either under the financial liability model or the grant of a right to the operator model (see IPSAS 32, *Service Concession Arrangements: Grantor*);**

    (h) **Financial instruments (see IPSAS 41, *Financial Instruments*); and**

    (i) **Social benefits (see IPSAS 42, *Social Benefits*).**

37. **Where a first-time adopter applies the exemption in paragraph 36(d), it shall recognize the obligation and any related plan assets at the same time.**

38. **Where a first-time adopter has recognized the assets and/or liabilities included in paragraph 36 under its previous basis of accounting, it is not required to change its accounting policy(ies) in respect of the measurement of these assets and/or liabilities for reporting periods beginning on a date within three years following the date of adoption of IPSASs.**

39. Subject to paragraphs 36 and 38, a first-time adopter is not required to change its accounting policy(ies) in respect of the recognition and/or measurement of assets and/or liabilities for reporting periods beginning on a date within three years following the date of adoption of IPSASs. The transitional exemptions in paragraphs 36 and 38 are intended to allow a first-time adopter a period to develop reliable[1] models for recognizing and/or measuring its assets and/or liabilities during the period of transition. The first-time adopter may apply accounting policies for the recognition and/or measurement of such assets and/or liabilities that do not comply with the provisions of other IPSASs.

40. **Subject to the provisions of paragraphs 36 and 38, a first-time adopter shall only change its accounting policies during the period of transition to better conform to the accounting policies in accrual basis IPSASs, and may retain its existing accounting policies until the exemptions that provided the relief have expired or when the relevant items are recognized and/or measured in the financial statements in accordance with the applicable IPSASs (whichever is earlier). A first-time adopter may change its accounting policy in respect of the recognition and/or measurement of assets and/or liabilities on a class-by-class or category-by-category basis where the use of classes or categories is permitted in the applicable IPSAS.**

41. **To the extent that a first-time adopter applies the exemptions in paragraphs 36 and 38 which allows a three year transitional relief period to not recognize and/or measure financial assets, it is not required to recognize and/or measure any related revenue in terms of IPSAS 9, *Revenue from Exchange Transactions*, or other receivables settled in cash or another financial asset in terms of IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers).***

Recognition and/or Measurement of Non-Exchange Revenue

42. **A first-time adopter is not required to change its accounting policy in respect of the recognition and measurement of non-exchange revenue for reporting periods beginning on a date within three years following the date of adoption of IPSASs. A first-time adopter may change its accounting policy in respect of revenue from non-exchange transactions on a class-by-class basis**.

43. The transitional provision in paragraph 42 is intended to allow a first-time adopter a period to develop reliable models for recognizing and measuring revenue from non-exchange transactions in accordance with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* during the period of transition. The first-time adopter may apply accounting policies for the recognition and/or measurement of revenue from non-exchange transactions that do not comply with the provisions of IPSAS 23. The transitional provision in paragraph 42 allows a first-time adopter to apply IPSAS 23 incrementally to different classes of revenue from non-exchange transactions. For example, a first-time adopter may be able to recognize and measure property taxes and some other classes of transfers in accordance with IPSAS 23 from the date of adoption of IPSASs, but may require three years to fully develop a reliable model for recognizing and measuring income tax revenue.

Other Exemptions

IPSAS 5, Borrowing Costs

44. **Where a first-time adopter applies the exemption in paragraph 36 which allows a three year transitional relief period to not recognize and/or measure assets, and elects to account for borrowing costs in terms of the allowed alternative treatment, it is not required to capitalize any borrowing costs on qualifying assets for which the commencement date for capitalization is prior to the date of adoption of accrual basis IPSASs, until the exemption that provided the relief has expired and/or when the relevant assets are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier).**

45. Paragraph 36 allows a first-time adopter to not, recognize and/or measure assets in accordance with IPSASs 16, 17, 27, 31 and 32 for a period of up to three years from the date of adoption of IPSASs. During this period, a first-time adopter may need to consider the requirements of those IPSASs at the same time as the capitalization of borrowing costs where it applies the allowed alternative method. Where a first-time adopter takes advantage of the transitional exemption period for the recognition and/or measurement of assets in accordance with IPSASs 16, 17, 27, 31 and 32 it is not required to capitalize borrowing costs incurred on qualifying assets prior, or during the period of transition. Only when the exemptions that provided the relief have expired, and/or when the relevant assets are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier) will a first-time adopter be allowed to capitalize borrowing costs incurred on the qualifying assets in accordance with the allowed alternative treatment.

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[1] Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent. Paragraph BC16 of IPSAS 1 discusses the transitional approach to the explanation of reliability.

IPSAS 43, *Leases*

46. **Where a first-time adopter takes advantage of the exemption in paragraph 36 which allows a three year transitional relief period to not recognize assets, it is not required to apply the requirements related to leases until the exemption that provided the relief has expired, and/or when the relevant assets are recognized in accordance with the applicable IPSASs (whichever is earlier).**

47. This IPSAS allows a first-time adopter a period of up to three years from the date of adoption of IPSASs to not recognize assets in accordance with IPSASs 16, 17, 27, 31 and 32. During this period, a first-time adopter may need to consider the recognition requirements of those IPSASs at the same time as considering the recognition of leases in this IPSAS. Where a first-time adopter takes advantage of the exemption in accordance with IPSASs 16, 17, 27, 31 and 32 it is not required to recognize lease assets and/or liabilities until the exemptions that provided the relief have expired, and/or when the relevant assets are recognized in accordance with the applicable IPSASs (whichever is earlier).

IPSAS 19, Provisions, Contingent Liabilities and Contingent Assets

48. **Where a first-time adopter takes advantage of the exemption in paragraph 36 which allows a three year transitional relief period to not recognize and/or measure property, plant and equipment, it is not required to recognize and/or measure the liability relating to the initial estimate of costs of dismantling and removing the item and restoring the site on which it is located until the exemption for IPSAS 17 has expired, and/or the relevant asset is recognized and/or measured in accordance with IPSAS 17 (whichever is earlier).**

49. This IPSAS allows a first-time adopter a period of up to three years from the date of adoption of IPSASs to not recognize and/or measure property, plant and equipment. IPSAS 17 requires an entity to include as part of the cost of an item of property, plant and equipment, the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. Where a first-time adopter takes advantage of the exemption that allows a three year transitional relief period for the recognition and/or measurement of property, plant and equipment, a first-time adopter is not required to apply the requirements related to the initial estimate of costs of dismantling and removing the item and restoring the site on which it is located until the exemption that provided the relief has expired, and/or when the relevant asset is recognized and/or measured in accordance with IPSAS 17 (whichever is earlier). The liability shall be measured as at the date of adoption of IPSASs, or where a first-time adopter has taken advantage of the exemption that allows a three year transitional relief period for the recognition and/or measurement of an asset, the date on which the exemption that provides the relief has expired and/or the asset has been recognized and/or measured in accordance with the applicable IPSASs.

50. **Where a first-time adopter takes advantage of the exemption in paragraph 48, it shall recognize and/or measure the obligation and any related asset at the same time.**

IPSAS 20, Related Party Disclosures

51. **A first-time adopter is not required to disclose related party relationships, related party transactions and information about key management personnel for reporting periods beginning on a date within three years following the date of adoption of IPSASs.**

52. **Notwithstanding the transitional provision in paragraph 51, a first-time adopter is encouraged to disclose information about related party relationships, related party transactions and information about key management personnel that is known at the date of adoption of IPSAS.**

IPSAS 34, Separate Financial Statements, IPSAS 35, Consolidated Financial Statements and IPSAS 36, Investments in Associates and Joint Ventures

53. **Where a first-time adopter has not recognized its interests in controlled entities, associates or joint ventures under its previous basis of accounting, it is not required to recognize and/or measure its interests in other entities as a controlled entity, associate or joint venture for reporting periods beginning on a date within three years following the date of adoption of accrual basis IPSAS.**

54. Subject to paragraph 53, a first-time adopter is not required to change its accounting policy in respect of the recognition and/or measurement of its interests in controlled entities, associates or joint ventures for reporting periods beginning on a date within three years following the date of adoption of IPSASs. The transitional exemption in paragraph 53 is intended to allow a first-time adopter a period to identify and appropriately classify its interests in other entities as either controlled entities, associates or joint ventures during the period of transition. The first-time adopter may apply accounting policies for the recognition and/or measurement of its interests in controlled entities, associates or joint ventures that do not comply with the provisions of other IPSASs.

IPSAS 35, Consolidated Financial Statements

55. **Subject to paragraph 53, a first-time adopter shall present consolidated financial statements following the adoption of accrual basis IPSASs. A first-time adopter presenting consolidated financial statements is, however, not required to eliminate all balances, transactions, revenue and expenses between entities within the economic entity for reporting periods beginning on a date within three years following the date of adoption of IPSASs.**

56. On adoption of IPSASs, an entity may have controlled entities with a significant number of transactions between controlled entities. Accordingly, it may be difficult to identify some transactions and balances that need to be eliminated for the purpose of preparing the consolidated financial statements of the economic entity. For this reason, paragraph 55 provides relief for a period of up to three years to fully eliminate balances, transactions, revenue and expenses between entities within the economic entity.

57. **Notwithstanding the transitional exemption in paragraph 55, a first-time adopter is encouraged to eliminate those balances, transactions, revenue and expenses that are known on the date of adoption of IPSASs to comply in full with the provisions of IPSAS 35 as soon as possible.**

58. **Where a first-time adopter has taken advantage of the transitional exemption in paragraph 53 and/or paragraph 55, it shall not present financial statements as consolidated financial statements until:**

   (a) **The exemptions that provided the relief have expired; and**

   (b) **Its interests in other entities have been appropriately recognized and/or measured as controlled entities, associates or joint ventures; or**

   (c) **Inter-entity balances, transactions, revenue and expenses between entities within the economic entity are eliminated (whichever is earlier).**

IPSAS 36, Investments in Associates and Joint Ventures

59. **When a first-time adopter applies the equity method on adoption of IPSAS 36, the investor is not required to eliminate its share in the surplus and deficit resulting from upstream and downstream transactions between the investor and its associate or joint venture for reporting periods beginning on a date within three years following the date of adoption of IPSASs.**

60. On adoption of IPSASs, a first-time adopter may be an investor in one or more associates or joint ventures with a significant number of upstream and downstream transactions between the investor and the investee. Accordingly, it may be difficult to identify some upstream and/or downstream transactions in which the investor's share in the associate's or joint venture's surplus or deficit needs to be eliminated in applying the equity method. For this reason, paragraph 59 provides the investor relief with a period of up to three years to fully eliminate its share in the associate's or joint venture's surplus or deficit resulting from upstream and/or downstream transactions.

61. **Notwithstanding the transitional exemption in paragraph 59, a first-time adopter is encouraged to eliminate its share in the associate's and joint venture's surplus and deficit resulting from upstream and downstream transactions that are known on the date of adoption of IPSASs, to comply in full with the provisions of IPSAS 36 as soon as possible.**

62. **Where a first-time adopter has taken advantage of the transitional exemption in paragraph 53 and/or paragraph 59, it shall not present financial statements in which investments in associates or joint ventures are accounted for using the equity method until:**

   (a) **The exemptions that provided the relief have expired; and**

   (b) **The interest in other entities have been appropriately recognized and/or measured as an associate or joint venture; or**

   (c) **Its share in the associate's surplus and deficit resulting from upstream and downstream transactions between the investor and the investee are eliminated (whichever is earlier).**

IPSAS 40, Public Sector Combinations

62A. **Where a first-time adopter applies the exemption in paragraph 36 which allows a three year transitional relief period to not recognize and/or measure assets and/or liabilities, the first-time adopter may be a party to a public sector combination during that three year transitional relief period. The first-time adopter is not required to recognize and/or measure the assets and/or liabilities associated with the public sector combination, until the exemption that provided the relief has expired and/or when the relevant assets and/or liabilities are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier).**

62B. **Where a first-time adopter applies the exemption in paragraph 62A it shall not recognize goodwill in respect of an acquisition. The first-time adopter shall recognize the difference between (a) and (b) below in net assets/equity:**

(a) **The aggregate of:**

(i) **Any consideration transferred;**

(ii) **Any non-controlling interests in an acquired operation; and**

(iii) **Any previously held equity interests in an acquired operation.**

(b) **The net amounts of any identifiable assets acquired and the liabilities assumed.**

62C. IPSAS 40 is applied prospectively. Consequently, a first-time adopter does not adjust any amounts of goodwill recognized as a result of a public sector combination that occurred prior to the application of IPSAS 40.

Exemptions that Do Not Affect Fair Presentation and Compliance with Accrual Basis IPSASs During the Period of Adoption

63. **A first-time adopter is required, or may elect, to adopt the exemptions in paragraphs 64–134. These exemptions will not affect the fair presentation of a first-time adopter's financial statements and its ability to assert compliance with accrual basis IPSASs during the period of transition in accordance with paragraphs 27 and 28 while they are applied. A first-time adopter shall not apply these exemptions by analogy to other items.**

Using Deemed Cost to Measure Assets and/or Liabilities

64. **A first-time adopter may elect to measure the following assets and/or liabilities at their fair value when reliable cost information about the assets and liabilities is not available, and use that fair value as the deemed cost for:**

(a) **Inventory (see IPSAS 12);**

(b) **Investment property, if the first-time adopter elects to use the cost model in IPSAS 16;**

(ba) **Right-of-use assets (see IPSAS 43);**

(c) **Property, plant and equipment (see IPSAS 17);**

(d) **Intangible assets, other than internally generated intangible assets (see IPSAS 31) that meets:**

(i) **The recognition criteria in IPSAS 31 (excluding the reliable measurement criterion); and**

(ii) **The criteria in IPSAS 31 for revaluation (including the existence of an active market);**

(e) **Financial Instruments (see IPSAS 41); or**

(f) **Service concession assets (see IPSAS 32).**

65. Deemed cost can only be determined where the acquisition cost of the asset and/or the liability is not available. Deemed cost assumes that the entity had initially recognized the asset and/ or the liability at the given date. Subsequent depreciation or amortization is based on that deemed cost on the premise that the acquisition cost is equal to the deemed cost. For example, a first-time adopter may elect to measure property, plant and equipment at deemed cost at the date of adoption of IPSASs because cost information about the item of property, plant and equipment was not available on that date, and use fair value as its deemed cost at that date. Any subsequent depreciation is based on the fair value determined at that date and starts from the date that the deemed cost has been determined.

66. The use of deemed cost is not considered a revaluation or the application of the fair value model for subsequent measurement in accordance with other IPSASs.

67. **A first-time adopter may elect to use the revaluation amount of property, plant and equipment under its previous basis of accounting as deemed cost if the revaluation was, at the date of the revaluation, broadly comparable to:**

(a) **Fair value; or**

(b) **Cost or depreciated cost, where appropriate, in accordance with IPSASs adjusted to reflect, for example, changes in a general or specific price index.**

68. A first-time adopter may have established a deemed cost in accordance with its previous basis of accounting for property, plant and equipment by measuring it at fair value at one particular date because of a specific event:

(a) If the measurement date is at or before the date of adoption of IPSASs, a first-time adopter may use such event-driven fair value measurements as deemed cost for IPSASs at the date of that measurement.

(b) If the measurement date is after the date of adoption of IPSASs, but during the period of transition where the first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure certain assets, the event-driven fair value measurements may be used as deemed cost when the event occurs. A first-time adopter shall recognize the resulting adjustments directly in accumulated surplus or deficit when the asset is recognized and/or measured.

69. In determining the fair value in accordance with paragraph 67, the first-time adopter shall apply the definition of fair value and guidance in other applicable IPSASs in determining the fair value of the asset in question. The fair value shall reflect conditions that existed at the date on which it was determined.

70. **If reliable market-based evidence of fair value is not available for inventory, or investment property that is of a specialized nature, a first-time adopter may consider the following measurement alternatives in determining a deemed cost:**

(a) **For inventory, current replacement cost; and**

(b) **For investment property of a specialized nature, depreciated replacement cost.**

Using Deemed Cost to Measure Assets Acquired Through a Non-Exchange Transaction

71. **A first-time adopter may elect to measure an asset acquired through a non-exchange transaction at its fair value when reliable cost information about the asset is not available, and use that fair value as its deemed cost.**

Using Deemed Cost for Investments in Controlled Entities, Joint Ventures and Associates (IPSAS 34)

72. **Where a first-time adopter measures an investment in a controlled entity, joint venture or associate at cost in its separate financial statements, it may, on the date of adoption of IPSASs, elect to measure that investment at one of the following amounts in its separate opening statement of financial position:**

(a) **Cost; or**

(b) **Deemed cost. The deemed cost of such an investment shall be its fair value (determined in accordance with IPSAS 41) at the first-time adopter's date of adoption of IPSASs in its separate financial statements.**

73. A first-time adopter may have established a deemed cost in accordance with its previous basis of accounting for an investment in a controlled entity, joint venture or associate by measuring it at its fair value at one particular date because of a specific event. In such instances, a first-time adopter applies paragraph 72(a) and (b).

Date at which Deemed Cost can be Determined

74. **The date at which deemed cost is determined may vary depending on whether the first-time adopter takes advantage of the exemptions that provides a three year transitional relief period to not recognize and/or measure certain assets and/or liabilities. When the first-time adopter takes advantage of the exemption, deemed cost can be determined at any date during this period, or on the date that the exemption expires (whichever is earlier), and shall be recognized in accordance with paragraph 76. If a first-time adopter does not adopt the exemption, deemed cost shall be determined at the beginning of the earliest period for which the first-time adopter presents IPSAS financial statements.**

75. Where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure certain assets and/or liabilities, it may determine a deemed cost for that asset and/or liability at any point of time within the three year transitional relief period.

76. **When a deemed cost is determined during the period in which a first-time adopter takes advantage of the exemption that provides a three year transitional exemption not to recognize and/or measure an asset and/or liability, a first-time adopter shall recognize the adjustment against the opening accumulated surplus or deficit in the year in which the deemed cost of the asset and/or liability is recognized and/or measured.**

IPSAS 1, Presentation of Financial Statements

Comparative Information

77. **A first-time adopter is encouraged, but not required, to present comparative information in its first transitional IPSAS financial statements or its first IPSAS financial statements presented in accordance with this IPSAS. When**

a first-time adopter presents comparative information, it shall be presented in accordance with the requirements of IPSAS 1.

78. **Where a first-time adopter elects to present comparative information, the first transitional IPSAS financial statements or the first IPSAS financial statements presented in accordance with this IPSAS shall include:**

(a) **One statement of financial position with comparative information for the preceding period, and an opening statement of financial position as at the beginning of the reporting period prior to the date of adoption of accrual basis IPSAS;**

(b) **One statement of financial performance with comparative information for the preceding period;**

(c) **One statement of changes in net assets/equity with comparative information for the preceding period;**

(d) **One cash flow statement with comparative information for the preceding period;**

(e) **A comparison of budget and actual amounts for the current year as a separate additional financial statement or as a budget column in the financial statements if the first-time adopter makes its approved budget publicly available; and**

(f) **Related notes including comparative information, and the disclosure of narrative information about material adjustments as required by paragraph 142.**

79. **Where a first-time adopter elects to not present comparative information, its first transitional IPSAS financial statements following the adoption of accrual basis IPSASs or its first IPSAS financial statements presented in accordance with this IPSASs shall include:**

(a) **One statement of financial position, and an opening statement of financial position at the date of adoption of accrual basis IPSAS;**

(b) **One statement of financial performance;**

(c) **One statement of changes in net assets/equity;**

(d) **One cash flow statement;**

(e) **A comparison of budget and actual amounts for the current year as a separate additional financial statement or as a budget column in the financial statements if the first-time adopter makes its approved budget publicly available; and**

(f) **Related notes and the disclosure of narrative information about material adjustments as required by paragraph 142.**

80. **Where a first-time adopter takes advantage of the exemptions in paragraphs 36–62 which allow a three year transitional relief period to not recognize and/or measure an item, comparative information for the year following the date of adoption of IPSASs shall be adjusted only when information is available about the items following their recognition and/or measurement during the relief period.**

81. IPSAS 1 requires an entity to present comparative information in respect of the previous period for all amounts reported in the financial statements. Where a first-time adopter takes advantage of the exemption that provides a three year transitional exemption to not recognize and/or measure an item, it shall, during the period of transition present comparative information for an item recognized and/or measured during that period only, if information is available about the item for the comparative period. The first-time adopter shall apply the requirements in IPSAS 1 after it has adjusted its first IPSAS financial statements.

Non-IPSAS Comparative Information

82. A first-time adopter may present comparative information in accordance with its previous basis of accounting. In any financial statements containing comparative information in accordance with the previous basis of accounting, the first-time adopter shall label the information prepared using the previous basis of accounting information as not being prepared in accordance with IPSASs, and disclose the nature of the main adjustments that would be required to comply with IPSASs.

83. Where a first-time adopter presents non-IPSAS comparative information in its first IPSAS or first transitional IPSAS financial statements following its adoption of accrual basis IPSASs, the transitional exemptions and provisions provided in this Standard shall not be applied to the non-IPSAS comparative information presented in the first IPSAS financial statements or first transitional IPSAS financial statements.

Non-IPSAS Historical Summaries

84. A first-time adopter may elect to present historical summaries of selected data for periods before the first period for which it presents financial statements in accordance with IPSASs. This IPSAS does not require such summaries to comply with the recognition and measurement requirements of IPSASs. In any financial statements containing historical summaries in accordance with the previous basis of accounting, the first-time adopter shall label the previous basis of accounting information prominently as not being prepared in accordance with IPSASs, and disclose the nature of the main adjustments that would be required to comply with IPSASs. The first-time adopter need not quantify those adjustments.

IPSAS 4, The Effects of Changes in Foreign Exchange Rates

85. **On the date of adoption of IPSASs a first-time adopter need not comply with the requirements for cumulative translation differences that exist at that date. If a first-time adopter uses this exemption:**

(a) **The cumulative translation differences for all foreign operations are deemed to be zero at the date of adoption of IPSASs; and**

(b) **The gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of adoption of IPSASs and shall include later translation differences.**

85A. **A first-time adopter need not apply Appendix A of IPSAS 4 to assets, expenses and revenue in the scope of Appendix A initially recognized before the date of adoption of IPSASs.**

85B. **Instead of applying paragraph 85, a controlled entity that uses the exemption in paragraph 129(a) may elect, in its financial statements, to measure cumulative translation differences for all foreign operations at the carrying amount that would be included in the controlling entity's consolidated financial statements, based on the controlling entity's date of adoption of IPSASs, if no adjustments were made for consolidation procedures and for the effects of the public sector combination in which the controlling entity acquired the controlled entity. A similar election is available to an associate or joint venture that uses the exemption in paragraph 129(a).**

86. **A first-time adopter shall apply the requirement to treat any goodwill (see IPSAS 40) arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation, as assets and liabilities of the foreign operation, prospectively on the date of adoption of IPSASs.**

87. In applying the transitional exemption in paragraph 85, a first-time adopter shall not restate prior years for the acquisition of a foreign operation acquired prior to the date of adoption of IPSASs, and accordingly shall, where appropriate, treat goodwill and fair value adjustments arising on acquisition as assets and liabilities of the entity rather than as assets and liabilities of the foreign operation. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate at the date of the acquisition.

IPSAS 5, Borrowing Costs

88. **A first-time adopter is encouraged, but not required, to apply the requirements of IPSAS 5 retrospectively where it adopts or changes its accounting policy to the benchmark treatment.**

89. **Where a first-time adopter adopts or changes its accounting policy to the benchmark treatment it is allowed to designate any date before the date of adoption of IPSASs and apply IPSAS 5 prospectively on or after that designated date.**

90. **Where a first-time adopter changes its accounting policy to the allowed alternative treatment, any borrowing costs incurred both before and after date of adoption of IPSASs on qualifying assets for which the commencement date for the capitalization is prior to the date of adoption of IPSASs, shall be recognized retrospectively in accordance with the allowed alternative treatment.**

IPSAS 10, Financial Reporting in Hyperinflationary Economies

Severe Hyperinflation

91. **If a first-time adopter has a functional currency that was, or is, the currency of a hyperinflationary economy, it shall determine whether it was subject to severe hyperinflation before the date of adoption of IPSASs.**

92. The currency of a hyperinflationary economy is subject to severe hyperinflation if it has both of the following characteristics:

(a) A reliable general price index is not available to all entities with transactions and balances in the currency; and

(b) Exchangeability between the currency and a relatively stable foreign currency does not exist.

93. The functional currency of a first-time adopter ceases to be subject to severe hyperinflation on the functional currency normalization date. That is the date when the functional currency no longer has either, or both, of the characteristics in paragraph 92 or when there is a change in the first-time adopter's functional currency to a currency that is not subject to severe hyperinflation.

94. **When a first-time adopter's date of adoption of IPSASs is on, or after, the functional currency normalization date, the first-time adopter may elect to measure all assets and liabilities held before the functional currency normalization date at fair value on the date of adoption to IPSASs. The first-time adopter may use that fair value as the deemed cost of those assets and liabilities in the opening statement of financial position.**

IPSAS 43, *Leases*

95. **A first-time adopter shall on the date of adoption of IPSAS, classify all existing leases as operating or finance leases on the basis of circumstances existing at the inception of the lease, to the extent that these are known on the date of adoption of IPSASs. A first-time adopter may assess whether a contract existing at the date of adoption of IPSASs contains a lease by applying paragraphs 10–12 of IPSAS 43 to those contracts on the basis of facts and circumstances existing at that date.**

96. [Deleted]

96A. When a fist-time adopter that is a lessee recognizes lease liabilities and right-of-use assets, it may apply the following approach to all of its leases (subject to the practical expedients described in paragraph 96C):

(a) Measure a lease liability at the date of adoption of IPSASs. A lessee following this approach shall measure that lease liability at the present value of the remaining lease payments (see paragraph 96D), discounted using the lessee's incremental borrowing rate (see paragraph 96D) at the date of adoption of IPSASs.

(b) Measure a right-of-use asset at the date of adoption of IPSASs. The lessee shall choose, on a lease-by-lease basis, to measure that right-of-use asset at either:

(i) Its carrying amount as if IPSAS 43 had been applied since the commencement date of the lease (see paragraph 96D), but discounted using the lessee's incremental borrowing rate at the date of adoption of IPSASs; or

(ii) An amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognized in the statement of financial position immediately before the date of adoption of IPSASs;

(c) Apply IPSAS 21 or IPSAS 26 to right-of-use assets at the date of adoption of IPSASs.

96B. Notwithstanding the requirements in paragraph 96A, a first-time adopter that is a lessee shall measure the right-of-use asset at fair value at the date of adoption of IPSASs for leases that meet the definition of investment property in IPSAS 16 and are measured using the fair value model in IPSAS 16 from the date of adoption of IPSASs.

96C. A first-time adopter that is a lessee may do one or more of the following at the date of adoption of IPSASs, applied on a lease-by-lease basis:

(a) Apply a single discount rate to a portfolio of leases with reasonably similar characteristics (for example, a similar remaining lease term for a similar class of underlying asset in a similar economic environment).

(b) Elect not to apply the requirements in paragraph 96A to leases for which the lease term (see paragraph 96D) ends within 12 months of the date of adoption of IPSASs. Instead, the entity shall account for (including disclosure of information about) these leases as if they were short-term leases accounted for in accordance with paragraph 7 of IPSAS 43.

(c) Elect not to apply the requirements in paragraph 96A to leases for which the underlying asset is of low value (as described in paragraphs AG4–AG9 of IPSAS 43). Instead, the entity shall account for (including disclosure of information about) these leases in accordance with paragraph 7 of IPSAS 43.

(d) Exclude initial direct costs (see paragraph 96D) from the measurement of the right-of-use asset at the date of adoption of IPSASs.

(e) Use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.

96D. Lease payments, lessor, lessee, lessee's incremental borrowing rate, commencement date of the lease, initial direct costs and lease term are defined terms in IPSAS 43 and are used in this Standard with the same meaning.

IPSAS 18, Segment Reporting

97. **A first-time adopter is not required to present segment information for reporting periods beginning on a date within three years following the date of adoption of IPSASs.**

IPSAS 21, Impairment of Non-Cash-Generating Assets

98. **A first-time adopter shall apply the requirements in IPSAS 21 prospectively from the date of adoption of IPSASs, except in relation to those assets where a first-time adopter takes advantage of the exemption in paragraph 36 which allows a three year transitional relief period to not recognize and/or measure assets. When a first-time adopter takes advantage of the exemption that provides a three year transitional relief period in IPSAS 16, 17, 27, 31 and 32, it applies IPSAS 21 when the exemption that provided the relief has expired, and/or the relevant assets are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier).**

99. **On the date that the transitional exemption that provided the relief has expired, and/or when the relevant assets are recognized and/or measured in the financial statements (whichever is earlier), a first-time adopter shall assess whether there is any indication that the non-cash-generating assets recognized and/or measured are impaired. Any impairment loss shall be recognized in opening accumulated surplus or deficit on the date of adoption of IPSASs, or in opening accumulated surplus or deficit in the reporting period in which the transitional exemption expires, and/or the relevant assets are recognized and/or measured (whichever is earlier).**

100. A first-time adopter shall apply the requirements of IPSAS 21 prospectively. This means that on the date of adoption of accrual basis IPSASs, or if the first-time adopter has adopted transitional relief relating to the recognition and/or measurement of assets, only when the three year transitional exemption expires, and/or when the relevant assets are recognized and/or measured in the financial statements (whichever is earlier), will a first-time adopter be required to assess whether there is an indication that any non-cash-generating assets included in the opening statement of financial position, are impaired.

IPSAS 39, Employee Benefits

101. **A first-time adopter shall recognize and/or measure all employee benefits on the date of adoption of IPSASs, except for defined benefit plans and other long-term employee benefits where it takes advantage of the exemption in paragraph 36.**

Defined Benefit Plans and Other Long-Term Employee Benefits

102. **On the date of adoption of IPSASs, or where a first-time adopter takes advantage of the three year transitional exemption, the date on which the exemption expires, or when the relevant liabilities are recognized and/or measured in the financial statements (whichever is earlier), a first-time adopter shall determine its initial liability for defined benefit plans and other long-term employee benefits at that date as:**

(a) **The present value of the obligation at the date of adoption of IPSASs, or where a first-time adopter takes advantage of the three year transitional relief period, the date on which the exemption expires, or when the relevant liabilities are recognized and/or measured in the financial statements (whichever is earlier), by using the Projected Unit Credit Method; and**

(b) **Minus the fair value, at the date of adoption of IPSASs, or where a first-time adopter takes advantage of the three year transitional relief period, the date on which the exemption expires, or when the relevant liabilities are recognized and/or measured in the financial statements (whichever is earlier) of plan assets (if any) out of which the obligations are to be settled directly.**

(c) [Deleted]

103. **If the initial liability in accordance with paragraph 102 is more or less than the liability that was recognized and/or measured at the end of the comparative period under the first-time adopter's previous basis of accounting, the first-time adopter shall recognize that increase/decrease in opening accumulated surplus or deficit in the period in which the items are recognized and/or measured.**

104. The effect of the change in the accounting policy to IPSAS 39 includes any remeasurements that arose, if any, in earlier periods. Under its previous basis of accounting, a first-time adopter may not have recognized and/or measured any liability, in which case the increase in the liability will represent the full amount of the liability minus the fair value, at the date of adoption of IPSASs or where a first-time adopter takes advantage of the three year transitional relief period, the date on which the exemption expires, or when the relevant liabilities are recognized and/or measured in the financial statements (whichever is earlier), of any plan assets in accordance with paragraph 102(b). This increased liability is recognized in opening accumulated surplus or deficit in the period in which the items are recognized and/or measured.

105. **A first-time adopter shall recognize all cumulative remeasurements in opening accumulated surplus or deficit in the period in which the items are recognized and/or measured.**

106. [Deleted]

107. [Deleted]

IPSAS 26, Impairment of Cash-Generating Assets

108. **A first-time adopter shall apply the requirements in IPSAS 26 prospectively from the date of adoption of IPSASs, except in relation to those assets where a first-time adopter takes advantage of the exemption in paragraph 36 which allows a three year transitional relief period to not recognize and/or measure assets. When a first-time adopter takes advantage of the exemption that provides a three year transitional relief period in IPSASs 16, 17, 27, 31 and 32, it applies IPSAS 26 when the exemption that provided the relief has expired, and/or the relevant assets are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier).**

109. **On the date that the transitional exemption that provided the relief has expired, and/or when the relevant assets are recognized and/or measured in the financial statements (whichever is earlier), a first-time adopter shall assess whether there is any indication that the cash-generating assets recognized and/or measured are impaired. Any impairment loss shall be recognized in opening accumulated surplus or deficit on the date of adoption of IPSASs, or in opening accumulated surplus or deficit in the reporting period in which the transitional exemption expires, and/or the relevant assets are recognized and/or measured (whichever is earlier).**

110. A first-time adopter shall apply the requirements of IPSAS 26 prospectively. This means that on the date of adoption of accrual basis IPSASs, or if the first-time adopter has adopted the transitional relief relating to the recognition and/or measurement of assets, only when the three year transitional exemption expires, and/or when the relevant assets are recognized and/or measured in the financial statements (whichever is earlier), will a first-time adopter be required to assess whether there is an indication that any cash-generating assets included in the opening statement of financial position, are impaired.

IPSAS 28, Financial Instruments: Presentation

111. **On the date of adoption of IPSASs, a first-time adopter shall evaluate the terms of the financial instrument to determine whether it contains both a liability component and a net asset/equity component. If the liability component is no longer outstanding on the date of adoption of IPSASs, the first-time adopter need not separate the compound financial instrument into a liability component and a net asset/equity component.**

112. IPSAS 28 requires an entity to split a compound financial instrument at inception into separate liability and net asset/equity components. If the liability component is no longer outstanding, retrospective application of IPSAS 28 involves separating two portions of net assets/equity. The first portion is in accumulated surplus and deficit and represents the cumulative interest accreted on the liability component. The other portion represents the original net asset/equity component. However, this IPSASs allows a first-time adopter to not separate these two portions if the liability component is no longer outstanding at the date of adoption of IPSASs.

IPSAS 41, *Financial Instruments*

Designation of Financial Instruments on the Date of Adoption of IPSAS or During the Period of Transition

113. **A first-time adopter may designate a financial asset or financial liability as a financial asset or financial liability at fair value through surplus or deficit that meet the criteria for designation in IPSAS 41, in accordance with paragraph 113A. A first-time adopter shall disclose the fair value of financial assets and financial liabilities designated into each category at the date of designation, their classification and carrying amount.**

113A. **IPSAS 41 permits a financial asset or financial liability to be designated on initial recognition (provided it meets certain criteria) as a financial asset or financial liability as at fair value though surplus or deficit. Despite this requirement, an exception applies when a first-time adopter is permitted to designate, at the date of adoption**

of IPSASs, any financial asset or financial liability as at fair value through surplus or deficit provided the asset meets the criteria in paragraph 44 of IPSAS 41 or liability meets the criteria in paragraph 46 of IPSAS 41 at that date.

114. [Deleted]

114A. An entity may designate an investment in an equity instrument as at fair value through net assets/equity in accordance with paragraph 106 of IPSAS 41 on the basis of the facts and circumstances that exist at the date of adoption of IPSASs.

Derecognition of Financial Assets and Financial Liabilities

115. **Except as permitted by paragraph 116 a first-time adopter shall apply the derecognition requirements in IPSAS 41 prospectively for transactions occurring on or after the date of adoption of IPSASs, or where a first-time adopter takes advantage of the exemptions not to recognize financial instruments, the date on which the exemptions that provided the relief have expired and/or the financial instruments are recognized (whichever is earlier). For example, if a first-time adopter derecognized non-derivative financial assets or non-derivative financial liabilities in accordance with its previous basis of accounting as a result of a transaction that occurred before the date of adoption of IPSASs, it shall not recognize those assets and liabilities in accordance with IPSAS 41, unless they qualify for recognition as a result of a later transaction or event.**

116. **Notwithstanding the provision in paragraph 115, a first-time adopter may apply the derecognition requirements in IPSAS 41 retrospectively from a date of the first-time adopter choosing, provided that the information needed to apply IPSAS 41 to financial assets and financial liabilities derecognized as a result of past transactions was obtained at the time of initially accounting for these transactions.**

Hedge Accounting

117. **As required by IPSAS 41, a first-time adopter shall at the date of adoption of IPSASs, or where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure financial instruments, the date when the exemption that provided the relief has expired and/or the relevant financial instruments are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier):**

   (a) **Measure all derivatives at fair value; and**

   (b) **Eliminate all deferred losses and gains arising on derivatives that were reported in accordance with its previous basis of accounting as if they were assets or liabilities.**

118. **A first-time adopter shall not reflect in its opening statement of financial position a hedging relationship of a type that does not qualify for hedge accounting in accordance with IPSAS 41 (for example, many hedging relationships where the hedging instrument is a stand-alone written option; or where the hedged item is a net position in a cash flow hedge for another risk than foreign currency risk). However, if a first-time adopter designated a net position as a hedged item in accordance with its previous basis of accounting, it may designate as a hedged item in accordance with IPSASs an individual item within that net position, or a net position if that meets the requirements in paragraph 146 of IPSAS 41, provided that it does so no later than the date of adoption of IPSASs or where it takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure financial instruments, the date when the exemption that provided the relief has expired, and/or the relevant financial instruments are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier).**

119. **If, before the date of adoption of IPSASs, or where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure financial instruments the date on which the exemption that provided the relief has expired, and/or the relevant financial instruments are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier), a first-time adopter had designated a transaction as a hedge but the hedge does not meet the conditions for hedge accounting in IPSAS 41, the first-time adopter shall apply paragraphs 135 and 136 of IPSAS 41 to discontinue hedge accounting. Transactions entered into before the date of adoption of IPSASs, or where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure financial instruments, the date when the transitional exemption expires and/or the relevant financial instruments are recognized and/or measured in accordance with IPSAS 41 (whichever is earlier), shall not be retrospectively designated as hedges.**

Classification and Measurement of Financial Instruments

119A. An entity shall assess whether a financial asset meets the conditions in paragraph 40 or the conditions in paragraph 41 of IPSAS 41 on the basis of the facts and circumstances that exist at the date of adoption of IPSASs.

119B. If it is impracticable to assess a modified time value of money element in accordance with paragraphs AG68–AG70 of IPSAS 41 on the basis of the facts and circumstances that exist at the date of transition to IPSASs, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the date of adoption of IPSASs without taking into account the requirements related to the modification of the time value of money element in paragraphs AG68–AG70 of IPSAS 41. (In this case, the entity shall also apply paragraph 49J of IPSAS 30 but references to 'paragraph 161 of IPSAS 41' shall be read to mean this paragraph and references to 'initial recognition of the financial asset' shall be read to mean 'at the date of adoption of IPSASs'.)

119C. If it is impracticable to assess whether the fair value of a prepayment feature is insignificant in accordance with paragraph AG74(c) of IPSAS 41 on the basis of the facts and circumstances that exist at the date of adoption of IPSASs, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the date of adoption of IPSASs without taking into account the exception for prepayment features in paragraph AG74 of IPSAS 41. (In this case, the entity shall also apply paragraph 49K of IPSAS 30 but references to 'paragraph 162 of IPSAS 41' shall be read to mean this paragraph and references to 'initial recognition of the financial asset' shall be read to mean 'at the date of adoption of IPSASs'.)

119D. If it is impracticable (as defined in IPSAS 3) for an entity to apply retrospectively the effective interest method in IPSAS 41, the fair value of the financial asset or the financial liability at the date of adoption of IPSASs shall be the new gross carrying amount of that financial asset or the new amortized cost of that financial liability at the date of adoption of IPSASs.

Impairment of Financial Assets

120. **A first-time adopter shall apply the impairment requirements prospectively from the date of adoption of IPSASs, except in relation to those financial assets where it takes advantage of the exemptions in paragraphs 36, 38 and 42 which allow a three year transitional relief period to not recognize and/or measure financial instruments. When a first-time adopter adopts the three year transitional relief period provided, it applies the impairment provisions when exemption that provided the relief has expired, and/or the relevant financial instruments are recognized and/or measured in accordance with IPSAS 41 (whichever is earlier).**

121. **A first-time adopter shall on the date of adoption of IPSASs, or when the exemptions that provided the relief have expired, and/or when the relevant financial instruments are recognized and/or measured and relevant information has been presented and/or disclosed in the financial statements in accordance with the applicable IPSAS (whichever is earlier), assess at that date whether there is any indication that the financial instrument recognized and/or measured in the statement of financial position, is impaired. Any impairment loss incurred shall be recognized in opening accumulated surplus or deficit in the period in which the financial instrument is recognized and/or measured.**

122. A first-time adopter shall apply the impairment requirements prospectively. This means that on the date of adoption of IPSAS 41, when the exemptions that provided the relief have expired, and/ or when the relevant financial instruments are recognized and/or measured, a first-time adopter shall be required to assess whether there is an indication that the financial instrument is impaired. Any impairment loss shall be recognized in opening accumulated surplus or deficit on the date of adoption of IPSASs, or in the opening accumulated surplus or deficit of the reporting period in which the exemptions that provided the relief have expired, and/or the relevant financial instruments are recognized and/or measured (whichever is earlier).

122A. At the date of adoption of IPSAS 41, when the exemptions that provided the relief have expired, and/ or when the relevant financial instruments are recognized and/or measured, a first-time adopter shall use reasonable and supportable information that is available without undue cost or effort to determine the credit risk at the date that financial instruments were initially recognized (or for loan commitments and financial guarantee contracts the date that the entity became a party to the irrevocable commitment in accordance with paragraph 78 of IPSAS 41) and compare that to the credit risk at the date of adoption of IPSASs (also see paragraphs AG350–AG351 of IPSAS 41).

122B. When determining whether there has been a significant increase in credit risk since initial recognition, an entity may apply:

(a) The requirements in paragraph 82 and AG179–AG182 of IPSAS 41; and

(b) The rebuttable presumption in paragraph 83 of IPSAS 41 for contractual payments that are more than 30 days past due if an entity will apply the impairment requirements by identifying significant increases in credit risk since initial recognition for those financial instruments on the basis of past due information.

122C. If, at the date of adoption of IPSASs, determining whether there has been a significant increase in credit risk since the initial recognition of a financial instrument would require undue cost or effort, an entity shall recognize a loss allowance at an amount equal to lifetime expected credit losses at each reporting date until that financial instrument is derecognized (unless that financial instrument is low credit risk at a reporting date, in which case paragraph 122B(a) applies).

Embedded Derivatives

122E. A first-time adopter shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on the basis of the conditions that existed at the later of the date it first became a party to the contract and the date a reassessment is required by paragraph AG109 of IPSAS 41.

IPSAS 30, Financial Instruments: Disclosures

123. **Where the first-time adopter elects to present comparative information in accordance with paragraph 78, it is not required to present information about the nature and extent of risks arising from financial instruments for the comparative period in its first transitional IPSAS financial statements or its first IPSAS financial statements.**

124. **A first-time adopter shall apply the requirements in IPSAS 30 prospectively from the date of adoption of IPSASs, or when the exemptions that provided the relief have expired, and/or when the relevant financial instrument is recognized and/or measured in accordance with IPSAS 41 (whichever is earlier).**

IPSAS 31, Intangible Assets

125. **A first-time adopter shall recognize and/or measure an internally generated intangible asset if it meets the definition of an intangible asset and the recognition criteria in IPSAS 31, even if the first-time adopter has, under its previous basis of accounting, expensed such costs. A deemed cost may not be determined for internally generated intangible assets.**

126. As required by paragraph 20, a first-time adopter is required to recognize all assets for which recognition is required by IPSASs. A first-time adopter shall therefore recognize any internally generated intangible asset if it meets the definition of an intangible asset and the recognition criteria in IPSAS 31, irrespective of whether such costs were expensed under its previous basis of accounting.

IPSAS 32, Service Concession Arrangements

Initial Measurement of Related Liability

127. **Where a first-time adopter elects to measure service concession assets using deemed cost, the related liabilities shall be measured as follows:**

(a) **For the liability under the financial liability model, the remaining contractual cash flows specified in the binding arrangement and the rate prescribed in IPSAS 32; or**

(b) **For the liability under the grant of a right to the operator model, the fair value of the asset less any financial liabilities, adjusted to reflect the remaining period of the service concession arrangement.**

128. **A first-time adopter shall recognize and/or measure any difference between the value of the service concession asset and the financial liability under the financial liability model in paragraph 127 in opening accumulated surplus or deficit in the period in which the items are recognized and/or measured.**

IPSAS 34, Separate Financial Statements, IPSAS 35, Consolidated Financial Statements and IPSAS 36, Investments in Associates and Joint Ventures

129. **If a controlled entity becomes a first-time adopter later than its controlling entity, except for the controlled entity of an investment entity, the controlled entity shall, in its financial statements, measure its assets and liabilities at either:**

(a) **The carrying amounts determined in accordance with this IPSAS that would be included in the controlling entity's consolidated financial statements, based on the controlled entity's date of adoption of IPSASs, if no adjustments were made for consolidation procedures and for the effects of the public sector combination in which the controlling entity acquired the controlled entity; or**

(b) **The carrying amounts required by the rest of this IPSAS, based on the controlled entity's date of adoption of IPSASs. These carrying amounts could differ from those described in (a):**

(i) **When the exemptions in this IPSAS result in measurements that depend on the date of adoption of IPSASs.**

(ii) **When the accounting policies used in the controlled entity's financial statements differ from those in the consolidated financial statements. For example, the controlled entity may use as its accounting policy the cost model in IPSAS 17, whereas the economic entity may use the revaluation model.**

A similar election is available to an associate or joint venture that becomes a first-time adopter later than an entity that has significant influence or joint control over it.

130. **However, if a controlling entity becomes a first-time adopter later than its controlled entity (or associate or joint venture) the controlling entity shall, in its consolidated financial statements, measure the assets and liabilities of the controlled entity (or associate or joint venture) at the same carrying amounts as in the financial statements of the controlled entity (or associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the public sector combination in which the controlling entity acquired the controlled entity (or associate or joint venture), subject to the exemptions that may be adopted in terms of this IPSAS. Similarly, if a controlled entity becomes a first-time adopter for its separate financial statements earlier or later than for its consolidated financial statements, it shall measure its assets and liabilities at the same amounts in both financial statements, subject to the exemptions that may be adopted in this IPSAS, except for consolidation adjustments.**

IPSAS 35, Consolidated Financial Statements

131. **A first-time adopter that is a controlled entity shall assess whether it is an investment entity on the basis of the facts and circumstances that exist at the date of adoption of accrual basis IPSASs, and measure its investment in each controlled entity at fair value through surplus or deficit at the date of adoption of accrual basis IPSASs.**

IPSAS 37, Joint Arrangements

132. **Where a first-time adopter accounted for its investment in a joint venture under its previous basis of accounting basis using proportionate consolidation, the investment in the joint venture shall be measured on the date of adoption as the aggregate of the carrying amount of the assets and liabilities that the entity previously proportionately consolidated, including any purchased goodwill arising from acquisition transactions (see IPSAS 40).**

133. **The opening balance of the investment determined in accordance with paragraph 132 is regarded as the deemed cost of the investment at initial recognition. A first-time adopter shall test the investment for impairment as at the date of adoption, regardless of whether there is any indication that the investment may be impaired. Any impairment loss shall be adjusted to the accumulated surplus or deficit at the date of adoption.**

134. **If aggregating all previously proportionately consolidated assets and liabilities results in negative net assets, the first-time adopter shall assess whether it has legal or constructive obligations in relation to the negative net assets and, if so, the first-time adopter shall recognize a corresponding liability. If the first-time adopter concludes that it does not have legal or constructive obligations in relation to the negative net assets, it shall not recognize the corresponding liability but it shall adjust accumulated surplus or deficit at the date of adoption. The first-time adopter shall disclose this fact, along with its cumulative unrecognized share of losses of its joint ventures as at the date of adoption of accrual basis IPSASs.**

IPSAS 42, *Social Benefits*

134A. **On the date of adoption of IPSASs, or where a first-time adopter takes advantage of the three year transitional exemption, the date on which the exemption expires, or when the relevant liabilities are recognized and/or measured in the financial statements (whichever is earlier), a first-time adopter shall determine its initial liability for a social benefit scheme at that date in accordance with IPSAS 42.**

134B. **If the initial liability in accordance with paragraph 134A is more or less than the liability that was recognized and/or measured at the end of the comparative period under the first-time adopter's previous basis of accounting, the first-time adopter shall recognize that increase/decrease in opening accumulated surplus or deficit in the period in which the items are recognized and/or measured.**

Disclosures

135. **A first-time adopter with financial statements that comply with the requirements of this IPSAS while taking advantage of the transitional exemptions and provisions that affect fair presentation and its ability to assert compliance with accrual basis IPSASs, shall make an explicit and unreserved statement of compliance with this IPSAS in the notes to the financial statements. This statement shall be accompanied by a statement that the financial statements do not fully comply with accrual basis IPSASs.**

136. **Where a first-time adopter takes advantage of the transitional exemptions in this IPSAS, the first-time adopter shall disclose:**

    (a) **The extent to which it has taken advantage of the transitional exemptions that affect the fair presentation of the financial statements and its ability to assert compliance with accrual basis IPSASs; and/or**

    (b) **The extent to which it has taken advantage of the transitional exemptions that do not affect the fair presentation of the financial statements and its ability to assert compliance with accrual basis IPSASs.**

137. **To the extent that a first-time adopter has taken advantage of the transitional exemptions and provisions in this IPSAS that affect fair presentation and compliance with accrual basis IPSASs in relation to assets, liabilities, revenue and/or expenses, it shall disclose:**

    (a) **Progress made towards recognizing, measuring, presenting and/or disclosing assets, liabilities revenue and/or expenses in accordance with the requirements of the applicable IPSAS;**

    (b) **The assets, liabilities, revenue and/or expenses that have been recognized and measured under an accounting policy that is not consistent with the requirements of applicable IPSAS;**

    (c) **The assets, liabilities, revenue and/or expenses that have not been measured, presented and/or disclosed in the previous reporting period, but which are now recognized and/or measured, and/or presented and/or disclosed;**

    (d) **The nature and amount of any adjustments recognized during the reporting period; and**

    (e) **An indication of how and by when it intends to comply in full with the requirements of the applicable IPSAS.**

138. **Where a first-time adopter takes advantage of the transitional exemption to not eliminate some balances, transactions, revenue and expenses, and/or where it applies the three year transitional relief for the recognition and/or measurement of its interest in controlled entities, associates or joint ventures in paragraph 55, it shall disclose the nature of the balances, transactions, revenue and expenses and/or upstream or downstream transactions that have been eliminated during the reporting period.**

139. **Where a first-time adopter is not able to present consolidated financial statements because of the transitional exemptions and provisions adopted in paragraphs 58 or 62, it shall disclose:**

    (a) **The reason why the financial statements, investments in associates or interests in joint ventures could not be presented as consolidated financial statements; and**

    (b) **An indication by when the first-time adopter will be able to present consolidated financial statements.**

140. **The disclosure requirements of paragraphs 135 and 139 will assist users to track the progress of the first-time adopter in conforming its accounting policies to the requirements in the applicable IPSASs during the period of transition.**

Explanation of Transition to IPSASs

141. **A first-time adopter shall disclose:**

    (a) **The date of adoption of IPSASs; and**

    (b) **Information and explanations about how the transition from the previous basis of accounting to IPSASs affected its reported financial position, and, where appropriate, its reported financial performance and cash flows.**

Reconciliations

142. **A first-time adopter shall present in the notes to its first transitional IPSAS financial statements or its first IPSAS financial statements:**

(a) **A reconciliation of its balance of net assets/equity reported in accordance with its previous basis of accounting to its opening balance of net assets/equity at the date of adoption of IPSASs; and**

(b) **A reconciliation of its accumulated surplus or deficit in accordance with its previous basis of accounting to its accumulated surplus or deficit at the date of adoption of IPSASs.**

A first-time adopter that has applied a cash basis of accounting in its previous financial statements is not required to present such reconciliations.

143. The reconciliation presented in accordance with paragraph 142 shall provide sufficient detail, both quantitative and qualitative, to enable users to understand the material adjustments to the opening statement of financial position and, where applicable, the restated comparative statement of financial performance presented in accordance with accrual basis IPSAS. Where narrative explanations are included in other public documents issued in conjunction with the financial statements, a cross reference to those documents shall be included in the notes.

144. If an entity becomes aware of errors made under its previous basis of accounting, the reconciliations required by paragraph 142 shall distinguish the correction of those errors from changes in accounting policies.

145. **If an entity did not present financial statements for previous periods, its transitional IPSAS financial statements or its first IPSAS financial statements shall disclose that fact.**

146. **Where a first-time adopter takes advantage of the exemptions in paragraph 36–43 which allow a three year transitional relief period to not recognize and/or measure items, it shall present as part of the notes, a reconciliation of items that have been recognized and/or measured during the reporting period when these items were not included in the previous reported financial statements. The reconciliation shall be presented in each period when new items are recognized and/or measured in accordance with this IPSAS.**

147. The reconciliation presented in accordance with paragraph 146 provides sufficient detail to enable users to understand which items have been recognized and/or measured during the reporting period where the first-time adopter adopts one or more of the exemptions that provide a three year transitional relief period to not recognize and/or measure an item. The reconciliation explains the adjustments to the previously reported statement of financial position and, where applicable, the previously reported statement of financial performance in each period when new items are recognized and/or measured in accordance with this IPSAS.

Disclosures where Deemed Cost is Used for Inventory, Investment Property, Property, Plant and Equipment, Intangible Assets, Right-of-Use Assets, Financial Instruments or Service Concession Assets

148. **If a first-time adopter uses fair value, or the alternative in paragraphs 64, 67 or 70, as deemed cost for inventory, investment property, property, plant and equipment, intangible assets, right-of-use assets, financial instruments, or service concession assets, its financial statements shall disclose:**

(a) **The aggregate of those fair values or other measurement alternatives that were considered in determining deemed cost;**

(b) **The aggregate adjustment to the carrying amounts recognized under the previous basis of accounting; and**

(c) **Whether the deemed cost was determined on the date of adoption of IPSASs or during the period of transition.**

Disclosures Where Deemed Cost is Used for Investments in Controlled Entities, Joint Ventures or Associates

149. **If a first-time adopter uses fair value as deemed cost in its opening statement of financial position for an investment in a controlled entity, joint venture or associate in its separate financial statements, its separate financial statements shall disclose:**

(a) **The aggregate deemed cost of those investments for which deemed cost is fair value; and**

(b) **The aggregate adjustment to the carrying amounts reported under the previous basis of accounting.**

150. **The disclosure requirements required in paragraph 148 and 149 shall be disclosed in each period when new items are recognized and/or measured until the exemptions that provided the relief have expired and/or when the relevant assets are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier).**

Exemptions from Disclosure Requirements in IPSASs During the Period of Transition

151. **To the extent that a first-time adopter takes advantage of the exemption that provides a three year relief period to not recognize and/or measure items, it is not required to apply any associated presentation and/or disclosure**

requirements related to such items as required in IPSAS 1, IPSAS 18 and/or the applicable IPSASs until such time as the exemptions that provided the relief have expired and/or when the relevant items have been recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier).

152. **Notwithstanding the transitional provision in paragraph 151, a first-time adopter is encouraged to disclose the information required by IPSAS 1, IPSAS 18 and/or the applicable IPSAS as soon as possible.**

Transitional Provisions

153. **Where a first-time adopter has adopted the existing transitional provisions in other accrual basis IPSASs, it shall continue to apply those transitional provisions until they expire and/or the relevant items are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier). If the first-time adopter elects to adopt the transitional exemptions in this IPSAS, the relief period applied in adopting accrual basis IPSASs, may not be longer than the relief period provided in this IPSAS.**

Effective Date and Transition

154. **A first-time adopter shall apply this Standard if its first IPSAS financial statements are for a period beginning on or after January 1, 2017. Earlier application is permitted.**

154A. **Paragraphs 7 and 8 were deleted by *The Applicability of IPSASs*, issued in April 2016. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2018, it shall disclose that fact.**

154B. **Paragraphs 36, 102, 104 and 105 were amended and paragraphs 106 and 107 were deleted by IPSAS 39, *Employee Benefits*, issued in July 2016. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies these amendments for a period beginning before January 1, 2018 it shall disclose that fact and apply IPSAS 39 at the same time.**

154C. **Paragraphs 86, 129, 130 and 132 were amended and paragraphs 62A–62C were added by IPSAS 40, *Public Sector Combinations*, issued in January 2017. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2019. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2019 it shall disclose that fact and apply IPSAS 40 at the same time.**

154D. **Paragraphs 36, 64, 72, 113, 114, 115, 116, 117, 118, 119, 120, 121, 122 and 124 were amended and paragraphs 114A, 119A, 119B, 119C, 119D, 122A, 122B, 122C, and 122D were added by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply IPSAS 41 at the same time.**

154E. **Paragraphs 78, 79, 123 and 142 were amended by *Improvements to IPSAS, 2018*, issued in October 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2019. Earlier application is permitted.**

154F. **Paragraph 85A was added by *Improvements to IPSAS, 2018*, issued in October 2018. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2019. Earlier application is permitted. If an entity applies this amendment for a period beginning before January 1, 2019 it shall disclose that fact and apply the amendments to IPSAS 4 included in *Improvements to IPSAS, 2018* at the same time.**

154G. **Paragraph 36 was amended and paragraphs 134A and 134B were added by IPSAS 42, *Social Benefits*, issued in January 2019. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2023 it shall disclose that fact and apply IPSAS 42 at the same time.**

154H. **Paragraph 113 was amended, paragraph 113A was added and paragraph 114 was deleted by *Improvements to IPSAS, 2019*, issued in January 2020. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is permitted. If an entity applies these amendments for a period beginning before January 1, 2023, it shall disclose that fact and apply IPSAS 41 at the same time.**

154I. **Paragraph 85B was added by *Improvements to IPSAS, 2021*, issued in January 2022. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is permitted. If an entity applies this amendment for an earlier period, it shall disclose that fact.**

154J. **Paragraphs 36, 46, 47, 64, 95, and 148, and the headings above paragraphs 46, 95, and 148 were amended, paragraph 96 was deleted, and paragraphs 96A, 96B, 96C, and 96D were added by IPSAS 43 issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.**

Appendix A

Amendments to Other IPSASs

[Deleted]

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 33.

Background

BC1. Prior to the development of IPSAS 33, there was no Standard that addresses issues arising from the first-time adoption of IPSASs. As a result, the IPSASB approved a project in June 2011 to develop a comprehensive set of principles to be used by entities on the adoption of accrual basis International Public Sector Accounting Standards (IPSASs).

BC2. While this IPSAS has Implementation Guidance, it is not within the scope of this project to develop more detailed practical guidance on the first-time adoption of IPSASs. The IPSASB is of the view that because specific issues relating to first-time adoption are likely to vary from one jurisdiction to the next, and because the starting point for first-time adopters varies depending on their previous basis of accounting, individual jurisdictions need to play a role in the development of additional implementation guidance to assist first-time adopters in their transition to accrual basis IPSASs.

BC3. This IPSAS addresses the transition from either a cash basis, or an accrual basis under another reporting framework, or a modified version of either the cash or accrual basis of accounting. Consequently, the IPSASB agreed that the project is not an IFRS convergence project.

BC4. The IPSASB did, however, consider the transitional exemptions included in IFRS 1 *First-time Adoption of International Financial Reporting Standards,* as well as the transitional provisions included in the existing suite of IPSASs, in developing this IPSAS.

BC5. In developing this IPSAS, the IPSASB agreed that, because this IPSAS is not a convergence project, all the transitional provisions and exemptions should be included in a single pronouncement. In comparison with IFRS 1, the IPSASB agreed that no transitional provisions and exemptions should be included as appendices, as this could be confusing to the preparers of the financial statements if the provisions and exemptions are dispersed all over the Standard.

BC6. The transitional exemptions provided in this IPSAS will replace many of the transitional provisions in IPSASs once they are applied.

BC7. When the IPSASB issues new pronouncements, it will consider specific transitional provisions to be included in this IPSAS that will provide relief to a first-time adopter. Transitional provisions for entities already applying accrual basis IPSASs will be included in the new pronouncements that are developed.

Scope

BC8. This IPSAS applies when an entity first adopts accrual basis IPSASs for the first time and during the period that it transitions to accrual basis IPSASs to the extent that it has adopted one or more of the transitional exemptions and provisions in this IPSASs. This IPSAS provides relief to a first-time adopter in presenting its financial statements, and allows a first-time adopter certain voluntary exemptions during the period of transition.

BC9. This IPSAS requires an entity to comply with each effective IPSAS on the date of adoption, but grants limited exemptions from requirements in certain areas where the benefits to users of financial statements are less than the cost of complying with those requirements. Retrospective application of some IPSASs is prohibited, particularly where they require judgment by management about past conditions.

BC10. The exemptions provided in this IPSAS may override some of the requirements in existing accrual basis IPSASs during the transition to accrual basis IPSASs.

BC11. The date of adoption of accrual basis IPSASs is the start of the reporting period in which the first-time adopter elects to adopt accrual basis IPSASs. If, on the date of adoption of accrual basis IPSASs the first-time adopter elects to apply one or more of the voluntary exemptions or provisions that affect fair presentation and the first-time adopter's ability to assert compliance with accrual basis IPSASs, the first-time adopter will present transitional IPSAS financial statements during the period of transition. At the end of the transitional period the first-time adopter must comply with the recognition, measurement, presentation and disclosure requirements in the other accrual basis IPSASs in order to assert compliance with accrual basis IPSASs as required in IPSAS 1, *Presentation of Financial Statements,* even though the date of adoption of accrual basis IPSAS may have been at an earlier point.

BC12. If, however, on the date of adoption of accrual basis IPSASs the first-time adopter elects not to apply one or more of the exemptions or provisions that affect fair presentation and the ability to assert compliance with accrual basis IPSASs, the first-time adopter can present IPSAS financial statements during the period of transition. IPSAS financial statements are financial statements in which the first-time adopter can make an explicit and unreserved statement in those financial statements of compliance with accrual basis IPSASs. If a first-time adopter does not adopt the exemptions in this IPSAS that affect fair presentation and compliance with accrual basis IPSASs, its first financial statements following the adoption of accrual basis IPSASs may also be its first IPSAS financial statements.

Developing Criteria to Develop and Assess Transitional Exemptions

BC13. In developing the transitional exemptions in this IPSAS, the IPSASB developed a set of criteria based on what user information needs are likely to be on the adoption of and transition to accrual basis IPSASs as set out in Chapter 2 of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (the Conceptual Framework)*. These criteria were used to evaluate these transitional provisions, along with an assessment of the qualitative characteristics, and constraints on, information included in GPFRs as outlined in Chapter 3 of the *Conceptual Framework*. The results of these evaluations are included in paragraphs BC14 to BC19.

BC14. In developing requirements for the first-time adopter's opening statement of financial position and in considering the transitional exemptions, the IPSASB referred to the objective of financial statements, as set out in Chapter 2 of the *Conceptual Framework.*

BC15. Chapter 2 of the *Conceptual Framework* states that the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in providing information for accountability and decision-making purposes.

BC16. Chapter 3 of the *Conceptual Framework* also identifies qualitative characteristics of information included in the general purpose financial reports (GPFRs) of public sector entities. These qualitative characteristics are relevance, faithful representation, understandability, timeliness, comparability and verifiability. The constraints on information included in GPFRs are materiality and cost-benefit.

Criteria Used to Develop the Transitional Exemptions

Fair Presentation and Compliance with IPSASs

BC17. IPSAS 1 requires that an entity whose financial statements comply with IPSASs shall make an explicit and unreserved statement of such compliance in the notes to the financial statements. Financial statements shall not be described as complying with IPSASs unless they comply with all the requirements of IPSASs. Due to the complexity of issues relating to the first-time adoption of IPSASs, the IPSASB agreed that relief should be provided in certain instances. The IPSASB however agreed that some relief will affect the fair presentation of a first-time adopter's financial statements and the ability to assert compliance with accrual basis IPSASs.

BC18. The IPSASB agreed that there should be a differentiation between those transitional exemptions which do not affect fair presentation of a first-time adopter's financial statements and those that do. The IPSASB also agreed that, structuring the Standard in this way will give preparers a better understanding of the affect that the various transitional provisions and exemptions will have on their financial statements during the period of transition. Following the differentiation the IPSASB agreed that first-time adopters should be alerted to the fact that they will not be able to assert compliance with accrual basis IPSASs as required by IPSAS 1 if they adopt certain exemptions provided in this IPSAS.

BC19. The IPSASB agreed that where a first-time adopter takes advantage of the exemptions that affect fair presentation and compliance with accrual basis IPSASs, it will not be able to make an unreserved statement of compliance with accrual basis IPSASs until such time as the exemptions that provided the relief have expired, or when the relevant items are recognized, measured and/or the relevant information has been presented and/or disclosed in the financial statements in accordance with the applicable IPSASs (whichever is earlier).

BC20. Following comment received on the proposed IPSAS on *First-time Adoption of Accrual Basis IPSAS*, the IPSASB agreed to clarify that a first-time adopter should apply judgment in assessing to what extent the transitional exemptions and provisions adopted affect fair presentation of the financial statements and the first-time adopter's ability to assert compliance with accrual basis IPSAS. Where a first-time adopter elects to apply one or more of the transitional exemptions and provisions that affect the fair presentation of the financial statements and its ability to assert compliance with accrual basis IPSAS, the first-time adopter may still conclude that fair presentation is achieved because the recognition and/or measurement of the item, transaction or event that are exempted is not significant in relation to the financial statements as a whole. Applying judgment to assess the significance of the transitional exemption and provision adopted in relation to the financial statements as a whole needs to be assessed based on the first-time adopter's specific circumstances.

BC21. The IPSASB agreed that the financial statements presented at the end of the first reporting period where a first-time adopter takes advantage of one of more of the transitional exemptions that affect fair presentation and compliance with accrual basis IPSASs, should be referred to as the transitional IPSAS financial statements. This is because the first-time adopter will not be able to make an explicit and unreserved statement of compliance with IPSASs while applying the exemptions in this IPSAS that affect the fair presentation of the financial statements and a first-time adopter's ability to assert compliance with accrual basis IPSASs.

BC22. To provide relevant information during the transition to accrual basis IPSASs disclosures to inform users about the transitional exemptions adopted by a first-time adopter, and how it transitions from its previous basis of accounting to accrual basis IPSASs.

BC23. The IPSASB noted that, as part of a first-time adopter's transition to accrual accounting, an implementation plan should be developed so as to assess the first-time adopter's progress reporting under accrual basis IPSASs. Disclosures on the progress towards recognizing, measuring, presenting and/or disclosing assets, liabilities, revenue and/or expenses in accordance with this plan will provide useful information to the users of financial statements in understanding how and by when the first-time adopter intends to comply in full with the requirements of all the applicable IPSASs.

Presentation of Information on First-Time Adoption

Presenting Comparative Information Following the Adoption of Accrual Basis IPSASs

BC24. The IPSASB considered whether comparative information should be required on the adoption of IPSASs, as the existing transitional provisions in IPSAS 1, *Presentation of Financial Statements* do not require comparative information in respect of the financial statements in which accrual accounting is first adopted in accordance with IPSASs.

BC25. In considering the cost-benefit criterion, the IPSASB confirmed that the current approach in IPSAS 1 for the presentation of comparative information should be retained to promote the adoption of accrual IPSASs. This IPSAS therefore only encourages the provision of comparative information, with no requirement that a first-time adopter should provide comparative information in its first transitional IPSAS financial statements, or first IPSAS financial statements.

BC26. Where a first-time adopter elects to not present comparative information, the IPSASB agreed that, as a minimum, a first-time adopter's first transitional IPSAS financial statements, should include one statement of financial position and an opening statement of financial position at the date of adoption of accrual basis IPSASs.

BC27. Where an entity elects to present comparative information, the IPSASB agreed that a first-time adopter should present one statement of financial position with comparative information for the preceding period and an opening statement of financial position as at the beginning of the reporting period prior to the date of adoption of accrual basis IPSASs.

BC28. As the adoption of the three year transitional relief period also affects the presentation of comparative information, the IPSASB agreed that where the first-time adopter takes advantage of any of the transitional relief periods permitted, it should only adjust comparative information for the year following the date of adoption of accrual basis IPSASs when information is available about the items that were recognized and/or measured during that period. Comparative information will thus only be adjusted retrospectively to the extent that the information is available.

BC29. A first-time adopter shall apply the requirements in IPSAS 1 relating to the disclosure of comparative information after it has presented its first IPSAS financial statements.

Presenting a Reconciliation Following the Adoption of Accrual Basis IPSASs

BC30. In considering what information would be useful to users of the financial statements in relation to the first-time adoption of IPSASs, the IPSASB agreed that a reconciliation should be presented in the notes to the transitional IPSAS financial statements, or first IPSAS financial statements. The presentation of a reconciliation provides an important link between the information previously presented under the first-time adopter's previous basis of accounting, and the information prepared using IPSASs. The purpose of the reconciliation is to illustrate the adjustments that are necessary to conform with the requirements of accrual basis IPSASs, and how the transition from the previous basis of accounting to IPSASs affected the first-time adopter's reported financial position, financial performance and cash flows. This information will be useful to the users of financial statements.

BC31. The IPSASB considered two types of reconciliations that could be presented – the first one reconciling opening balances as at the date of adoption of IPSASs, and the second a reconciliation reconciling the end of the latest period presented in the first-time adopter's most recent annual financial statements in accordance with its previous basis of accounting.

BC32. The IPSASB concluded that the latter option will be too onerous and that the cost of presenting the reconciliation, outweighs the benefit. It was also concluded that users will not likely make use of such reconciliations and that the information will not have predictive value.

BC33. As a result, it was agreed that a first-time adopter should only present a reconciliation of its closing balances reported under its previous basis of accounting, to its net assets/equity in accordance with IPSASs for the opening statement of financial position. The information should be presented in the notes to the transitional IPSAS financial statements, or the first IPSAS financial statements.

BC34. If a first-time adopter previously applied a cash basis of accounting it would not have presented net assets/equity. The IPSASB therefore agreed that if a first-time adopter's previous basis of accounting is cash, it is not required to present a reconciliation.

BC35. To meet the qualitative characteristics of relevance, understandability and comparability during the period of transition where a first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of assets and/or liabilities, the IPSASB considered whether a first-time adopter should be required to present a reconciliation at different points during its transition to accrual basis IPSASs.

BC36. The IPSASB agreed that where a first-time adopter takes advantage of any of the transitional relief periods permitted, it should present a reconciliation of items that have been recognized and/or measured during the reporting period when these items have not been recognized and/or measured in the previous reported financial statements. This reconciliation should be presented in addition to the reconciliation that is presented to explain differences between the first-time adopter's previous basis of accounting and those items that are recognized and/or measured in accordance with IPSASs in the opening statement of financial position.

Presenting a Comparison of Budget and Actual Information in a First-time Adopter's Financial Statements

BC37. The IPSASB debated whether a first-time adopter should be required to present a comparison of budget and actual information following the adoption of accrual basis IPSASs, and whether such information is useful to the users of the financial statements.

BC38. The IPSASB considered that if a first-time adopter prepares its budget on the cash-basis of accounting after the adoption of IPSASs, presenting this comparison in its transitional IPSAS financial statements, or its first IPSAS financial statements could be onerous. The IPSASB, however, agreed that such a comparison should be included in a first-time adopter's financial statements, as the comparison is a unique feature of IPSASs and promotes accountability and decision-making.

Presenting a Cash Flow Statement in a First-time Adopter's Financial Statements

BC39. During the comment period, respondents requested the IPSASB to consider providing transitional exemptions and provisions for the preparation of the cash flow statement where a first-time adopter elects to adopt a three year relief period for the recognition and/or measurement of certain assets and/or liabilities. Respondents noted that it did not seem appropriate to present a cash flow statement when the statement of financial position is incomplete.

BC40. The IPSASB confirmed its previous decision to not provide any transitional relief as, during the transitional period, users still need cash flow information on: (a) the sources of cash inflows: (b) the items on which cash was expensed during the reporting period; and (c) the cash balance as at the end of the reporting period.

Alignment of Accrual IPSASs and Government Finance Statistics Reporting

BC41. As the objective of this Standard is to provide a suitable starting point for accounting in accordance with accrual basis IPSAS it does not provide specific guidance to a first-time adopter on alignment of GFS reporting and accrual basis IPSASs. In its Consultation Paper, *Alignment of IPSASs and Government Finance Statistics Reporting Guidelines: Resolution of Differences through Convergence and Management*, the IPSASB discusses where guidance on GFS alignment options within the suite of IPSASB's pronouncements will be best addressed. By choosing Government Finance Statistics (GFS) aligned policy options on the first-time adoption of accrual IPSASs, a first-time adopter may facilitate production of high quality and timely data for inclusion in their GFS reports.

Exemptions that Affect Fair Presentation and Compliance with Accrual Basis IPSAS

Transitional Exemptions Relating to the Recognition, Measurement and Classification of Non-Financial Assets

BC42. When an entity first adopts IPSASs, it may not have comprehensive information about the existence of all the assets under its control, and may require a period of time to obtain and compile appropriate records to account for such assets. As this is relevant to entities that previously did not apply the accrual basis of accounting, it is likely that these entities will require considerable effort to recognize, measure and/or classify their assets in accordance with IPSASs.

BC43. In considering the relief that should be provided to a first-time adopter for the recognition of its assets, the IPSASB considered the existing five year relief period in IPSAS 17. To encourage entities to prepare for the adoption of IPSASs in advance of the preparation of their transitional IPSAS financial statements, or their first IPSAS financial statements, the IPSASB agreed that a grace period not exceeding three years should be allowed. As entities should prepare well in advance for their transition to accrual basis IPSASs and not solely rely on the relief period provided in this IPSAS, the IPSASB is of the view that the three year transitional period is more manageable, and reduces the period over which entities will not be able to assert compliance with IPSASs.

BC44. The IPSASB agreed that prescribing a relief period in this IPSAS, rather than allowing each jurisdiction to prescribe their own transitional period, reduces inconsistencies between jurisdictions. The credibility and comparability of financial statements during the period of transition will also be enhanced.

BC45. The IPSASB confirmed that the relief provided in this IPSAS should not be seen as a complete roadmap for the adoption of accrual basis IPSASs, but rather the end stage of their adoption process. The relief period of three years provided in this IPSAS is aimed at providing relief to a first-time adopter to assist with the final conversion to accrual basis IPSASs. Prior to the adoption of this IPSAS, a first-time adopter should adequately prepare for its transition to accrual basis IPSASs. The complexity and length of the transition will depend on its previous basis of accounting. The three year relief period should not be seen as the entire adoption phase.

BC46. The guidance in Study 14, *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities* issued by the IPSASB may assist a first-time adopter in planning their conversion to accrual basis IPSASs, prior to adoption of this IPSAS.

BC47. The IPSASB proposed that a relief period of three years should be provided for the following assets:

(a) Investment property;

(b) Property, plant and equipment;

(c) Biological assets and agricultural produce;

(d) Intangible assets; and

(e) Service concession assets.

BC48. Following comment received on this proposed IPSAS, the IPSASB agreed to also allow a relief period for the recognition and/or measurement of inventory. The IPSASB agreed that, even though inventory is a current asset which is realised, consumed, sold or used in an entity's operating cycle, a first-time adopter may need time to identify and classify its assets appropriately between inventory, investment property or property, plant and equipment, particularly in respect of land. Inventory may also comprise specialized assets or high volumes of items, e.g. medical supplies, for which additional time may be required for appropriate classification.

BC49. In considering whether a relief period should be allowed for the recognition of biological assets and agricultural produce, the IPSASB noted that these assets and activities may be limited in some jurisdictions while they may be more significant in other jurisdictions, for example, developing countries. On balance, the IPSASB agreed that a three year relief period should be provided for the recognition of biological assets and agricultural produce to assist those jurisdictions where this is a significant issue.

BC50. IPSAS 5 allows a first-time adopter to either adopt the benchmark treatment or the allowed alternative treatment in accounting for borrowing costs incurred on qualifying assets. When a first-time adopter elects to apply the allowed alternative treatment, there may a timing difference between the capitalization of borrowing costs on qualifying assets where the first-time adopter takes advantage of the three year transitional relief period to not recognize certain assets. To address this timing difference, and because it might not be practical to obtain information on borrowing costs incurred prior to the recognition of the asset where the first-time adopter takes advantage of the three year transitional exemption period, the IPSASB agreed that a first-time adopter should not be required to capitalize any borrowing costs on qualifying assets for which the commencement date for capitalization is prior to the date of adoption of accrual basis IPSASs. Based on comment received from respondents on the proposed Exposure Draft, the IPSASB also agreed that any borrowing costs incurred during the period of transition should also not be capitalized until the exemptions that provided the relief have expired and/or when the relevant assets are recognized in accordance with the applicable IPSASs (whichever is earlier).

BC51. After comment received on the proposed IPSAS, the IPSASB also agreed that a first-time adopter may change its accounting policy in respect of the recognition and/or measurement of assets and/or liabilities on a class-by-class or category-by-category basis where the use of classes or categories are permitted in the applicable IPSAS.

Transitional Exemptions relating to the Measurement of Non-Financial Assets

BC52. The IPSASB acknowledged that some entities may have recognized non-financial assets under their previous basis of accounting. The IPSASB therefore agreed that a three year transitional relief period should be allowed for the measurement of all non-financial assets that were recognized by a first-time adopter under its previous basis of accounting. During this transitional period, a first-time adopter will be able to develop reliable models for applying the principles in the IPSASs. During the transitional period the first-time adopter will not be required to change its accounting policy in respect of the measurement of these assets.

Transitional Exemptions Relating to the Recognition of Liabilities

Interaction Between the Asset Standards and Other IPSASs

BC53. Where a first-time adopter takes advantage of one or more of the transitional exemptions relating to the recognition of assets, it would, as part of this process, analyze title deeds, contracts and other similar arrangements, including lease arrangements, in determining what assets should be accounted for and their measurement. As a result, a first-time adopter may not be in a position to account for finance lease liabilities related to finance lease assets until such time as the transitional relief period provided has expired and/or the relevant assets are recognized in accordance with the applicable IPSASs (whichever is earlier).

BC54. Likewise, where a first-time adopter has elected to adopt the transitional relief provided for the recognition of service concession assets in accordance with IPSAS 32, it will not be in a position to account for the related liability under either the financial liability model or the grant of a right to the operator model until such time as the transitional relief period provided has expired and/or the relevant assets are recognized and/or measured in accordance with IPSAS 32 (whichever is earlier).

BC55. The IPSASB agreed that the recognition of finance lease liabilities and the recognition and/or measurement of liabilities related to service concession assets should also be delayed until the relief period related to the relevant assets have expired and/or the applicable assets have been recognized and/or measured.

Recognition of Provisions Included in the Initial Cost of Property, Plant and Equipment

BC56. The IPSASB concluded that no transitional relief period should be provided for provisions in IPSAS 19 and that a first-time adopter should account for all its liabilities on the date of adoption of IPSASs. The IPSASB, however, acknowledges that the delay in the recognition and/or measurement of property, plant and equipment affects the recognition and/or measurement of certain provisions which are included in the cost of such assets.

BC57. IPSAS 17 requires an entity to include, as part of the cost of an item of property, plant and equipment, the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation which an entity incurs either when the item is acquired, or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period. IPSAS 17 requires that the obligation for costs accounted for in accordance with IPSAS 17 is recognized and measured in accordance with IPSAS 19.

BC58. The IPSASB agreed that it would not be possible to recognize and/or measure provisions for the initial estimate of costs to dismantle and remove the item and restore the site on which it is located until such time as the relevant item of property, plant and equipment is recognized and/or measured in accordance with IPSAS 17. A transitional relief period was therefore also provided for the recognition and/or measurement of the provision to address the timing difference.

IPSAS 39, Employee Benefits

BC59. The IPSASB acknowledged that the recognition and/or measurement of specific liabilities in IPSAS 39, will be challenging for many public sector entities as new systems may be required and/or existing systems may need to be upgraded. The IPSASB therefore agreed that a first-time adopter should be given a three year relief period for the recognition and/or measurement of assets and liabilities related to defined benefit plans and other long-term employee benefits. To avoid a skewed statement of financial position, the IPSASB further agreed that any plan assets should be recognized and/or measured at the same time as the liabilities. All other employee benefits should be recognized and/or measured on the date of adoption of IPSASs.

BC60. [Deleted]

IPSAS 42, *Social Benefits*

BC60A. The IPSASB issued IPSAS 42, *Social Benefits*, in January 2019. The IPSASB acknowledged that the recognition and/or measurement of liabilities related to social benefits may be challenging for some public sector entities. The IPSASB therefore agreed that a first-time adopter should be given a three year relief period for the recognition and/or measurement of liabilities related to social benefits.

Transitional Exemptions Relating to the Recognition and Measurement of Monetary Assets and/or Liabilities

IPSAS 41, Financial Instruments

BC61. The existing transitional provisions in IPSAS 41 do not provide any relief to a first-time adopter for the recognition and/or measurement of financial instruments. Because many public sector entities will need some time to identify and appropriately classify their financial instruments, the IPSASB agreed that a transitional relief period should be provided to a first-time adopter for the recognition and/or measurement of financial instruments. A transitional relief period of three years was granted in line with the relief period provided for the recognition and/or measurement of other items.

BC62. The IPSASB, however, agreed that a distinction should be made between those entities that previously recognized financial instruments and those that did not. The IPSASB was of the view that many basic financial instruments such as cash, debtors and creditors are already recognized by public sector entities. A three year relief period for the recognition of financial instruments that have not been recognized under a first-time adopter's previous basis of accounting, is therefore provided.

BC63. As with non-monetary assets, the IPSASB agreed that the same principle should be applied to the recognition and/or measurement of monetary assets and/or liabilities, i.e. to the extent that a first-time adopter has recognized financial instruments under its previous basis of accounting, the IPSASB agreed that a three year relief period should be granted for the measurement and classification of financial instruments following the date of adoption of IPSASs. During this transitional period, a first-time adopter will be able to develop reliable models for applying the principles in IPSAS 41. It would also be allowed to apply accounting policies for the measurement of financial instruments that differs from the requirements in IPSAS 41 during the period of transition.

Transitional Exemptions Relating to the Recognition and Measurement of Non-Exchange Revenue

IPSAS 23, Revenue from Non-Exchange Transactions (Taxes and Transfers)

BC64. The existing transitional provisions in IPSAS 23 allow a first-time adopter to not change its accounting policy in respect of the recognition and measurement of taxation revenue for a period of five years. IPSAS 23 also allows a first-time adopter to not change its accounting policy in respect of recognition and measurement of revenue from non-exchange transactions, other than taxation revenue, for a period of three years. It also requires that changes in accounting policies should only be made to better conform to IPSAS 23.

BC65. The IPSASB concluded that it will be challenging for many public sector entities to implement IPSAS 23 as new systems may be required and/or existing systems may need to be upgraded. Because of these practical challenges, the IPSASB agreed that a transitional relief period should be provided. The IPSASB, however, acknowledged that a first-time adopter should build up models to assist with the transition to accrual accounting prior to the adoption of the accrual basis. In line with the relief period of three years provided for the recognition of assets and/or liabilities in other IPSASs, and in line with the existing three year transitional relief period provided for other non-exchange revenue in IPSAS 23, it was agreed that a first-time adopter should be granted a relief period of three years to develop reliable models for recognizing and measuring revenue from non-exchange transactions. The IPSASB agreed that a transitional period of three years is manageable, and reduces the period over which an entity will not be able to assert compliance with accrual basis IPSASs. During the period of transition, a first-time adopter will be allowed to apply accounting policies for the recognition of non-exchange revenue transactions that do not comply with the provisions in IPSAS 23.

Exemptions from Presentation and/or Disclosure Requirements Where a First-time Adopter Takes Advantage of the Exemptions that Provide a Three Year Transitional Relief Period

BC66. The IPSASB acknowledged and agreed that the three year exemption provided for the recognition and/or measurement of assets and/or liabilities also implies that the associated presentation and/or disclosure requirements in the applicable IPSASs do not need to be complied with as the information will not be available. The IPSASB agreed that the information need not be provided until the exemptions that provided the relief have expired or when the relevant assets and/or liabilities are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier).

BC67. For the same reason, the IPSASB agreed that a first-time adopter should not be required to provide any related disclosure requirements in IPSAS 1, *Presentation of Financial Statements* and IPSAS 18, *Segment Reporting.*

IPSAS 5, Borrowing Costs

BC68. The existing transitional provisions in IPSAS 5 encouraged a first-time adopter to adjust its financial statements retrospectively if it did not recognize borrowing costs under its previous basis of accounting. The IPSASB agreed that it does not want to provide more relief to a first-time adopter than to those entities that already apply IPSASs, particularly where the first-time adopter elects to adopt the allowed alternative treatment under which borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are capitalized as a part of the cost of an asset.

BC69. As a result, the IPSASB agreed that a first-time adopter should only be encouraged to apply the requirements of IPSAS 5 retrospectively where it adopts or changes its accounting policy to the benchmark treatment. Providing this relief was seen a necessary because obtaining information retrospectively may be costly and considerable effort may be needed to obtain such information.

BC70. The IPSASB, however acknowledged that some information may be available to a first-time adopter depending on its previous basis of accounting. It was therefore agreed that a first-time adopter who adopted or changed its accounting policy to the benchmark treatment, should apply the principles in IPSAS 5 prospectively, but it may designate a date before the date of adoption of IPSASs in applying IPSAS 5. This relief can only be adopted to the extent that the information is available.

BC71. The IPSASB does not want to encourage first-time adopters to adopt the allowed alternative treatment. Therefore it was agreed that where a first-time adopter changes its accounting policy to the allowed alternative treatment, any borrowing costs incurred on qualifying assets both before and after the date of adoption of IPSASs, for which the commencement date for capitalization is prior to the date of adoption of IPSASs, should be recognized retrospectively where the first-time adopter has not taken advantage of the transitional relief to not recognise and/or measure assets for a period of three years.

IPSAS 34, Separate Financial Statements, IPSAS 35, Consolidated Financial Statements and IPSAS 36, Investments in Associates and Joint Ventures

BC72. The IPSASB considered whether it should provide transitional relief that allows a first-time adopter to not present consolidated financial statements on adoption of IPSASs. In considering this proposal, it was argued that providing such an exemption would contradict the concept of a reporting entity and would not result in fair presentation.

BC73. The IPSASB therefore agreed that providing a relief period to not present consolidated financial statements should not be provided, but instead, a first-time adopter should be given a three year relief period from eliminating balances, transactions, revenues and expenses between entities within the economic entity.

BC74. As some balances, transactions, revenues and expenses may be known on adoption of IPSASs, a first-time adopter is encouraged to eliminate only those known balances, transactions, revenues and expenses.

BC75. For the same reason, the IPSASB agreed that a similar exemption should also be provided where a first-time adopter has one or more jointly controlled entity in terms of IPSAS 8, and where it has one or more associate in terms of IPSAS 7.

Providing a three year relief for the initial recognition and/or measurement of interests in other entities

BC76. Following comments received on Exposure Draft, the IPSASB agreed that relief should be provided to a first-time adopter for the initial recognition and/or measurement of its interests in other entities. This relief would allow those first-time adopters that have not gathered the necessary information on the date of adoption, more time to appropriately classify and measure their interests in other entities. The relief provided is consistent with that provided for financial instruments.

Presenting consolidated financial statements where the three year relief is adopted for the initial recognition and/or measurement of interests in other entities and/or to not eliminate inter-entity balances, transactions, revenue and expenses

BC77. Some respondents to the Exposure Draft expressed a view that relief should be provided from preparing consolidated financial statements where a first-time adopter has elected to not eliminate some, or all of the inter-entity balances, transactions, revenue and expenses between entities within the economic entity. The IPSASB concluded that the financial statements that are presented where a first-time adopter has taken advantage of the three year relief for the initial recognition and/or measurement of interests in other entities, and/or where it has elected to not eliminate some, or all inter-entity balances, transactions, revenue and expenses, cannot be presented as consolidated financial statements, until (a) the exemptions that provided the relief have expired, and/or (b) inter-entity balances, transactions, revenue and expenses have been eliminated, and/or (c) its interests other entities have been recognized and/or measured appropriately. The IPSASB agreed that disclosure requirements should be added to explain to users why the financial statements are not presented as consolidated financial statements.

BC78. The IPSASB agreed that providing this clarification is necessary because, where a first-time adopter has not eliminated inter-entity balances, transactions, revenue and expenses as required by IPSAS 35 preparing consolidated financial statements will merely be an aggregation of inter-entity balances, transactions, revenue and expenses within the economic entity. Such statements would not be useful for accountability and decision-making purposes.

BC79. Likewise eliminating the carrying amount of an investment in the controlled entity as required by IPSAS 35 may not be possible if the first-time adopter has not recognized and/measured its interest in other entities as required by the applicable IPSASs.

IPSAS 40, Public Sector Combinations

BC79A. In developing IPSAS 40, *Public Sector Combinations*, the IPSASB considered whether it should provide transitional relief that allows a first-time adopter not to recognize and/or measure all the assets and/or liabilities associated with a public sector combination. The IPSASB noted that IPSAS 40 is applied prospectively, and so its application would not require a first-time adopter to adjust their accounting for a public sector combination that occurred prior to the application of that Standard. However, a public sector combination could occur during a first-time adopter's three year transitional relief period. The IPSASB considered that requiring a first-time adopter to recognize and measure all the assets and liabilities associated with a public sector combination without requiring them to recognize and measure all similar assets and liabilities would not provide useful information for the users of the financial statements.

BC79B. Consequently, the IPSASB agreed to provide transitional relief that allows a first-time adopter not to recognize and/or measure all the assets and/or liabilities associated with a public sector combination as part of this Standard. The IPSASB also agreed that a first-time adopter should not recognize goodwill where it did not recognize and/or measure all the assets and/or liabilities associated with a public sector combination.

Exemptions that Do Not Affect Fair Presentation and Compliance with Accrual Basis IPSAS

Deemed Cost

Deemed Cost for Assets and/or Liabilities

BC80. Some measurements in accordance with IPSASs are based on an accumulation of past costs or other transaction data. If a first-time adopter has not previously collected the necessary information, collecting or estimating it retrospectively may be costly and/or impractical. To avoid excessive cost, this IPSAS allows a first-time adopter to use the fair value as a substitute for the initial cost of inventory, investment property where the first-time adopter elects to use the cost model in IPSAS 16, property, plant and equipment, financial instruments and service concession assets at the date of adoption of IPSASs. Where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure certain assets, the fair value is the deemed cost at the date at which the asset is recognized and/or measured during the period of transition.

BC81. While it could be argued that the use of fair value would lead to a lack of comparability, the IPSASB noted that cost is generally equivalent to fair value at the date of acquisition. Therefore, the use of fair value as the deemed cost of an asset means that a first-time adopter reports the same cost data as if it had acquired an asset with the same value or same remaining service potential at the date of adoption of IPSASs. If there is any lack of comparability, it arises from the aggregation of costs incurred at different dates, rather than from the use of fair value as deemed cost for some assets at a date. In the view of the IPSASB, using deemed cost facilitates the introduction of IPSASs in a cost-effective way.

BC82. Under the revaluation model in IPSAS 17, if an entity revalues an asset, it must revalue all assets in that class. This restriction prevents selective revaluation of only those assets whose revaluation would lead to a particular result. The IPSASB considered whether a similar restriction should be included in determining a deemed cost. IPSAS 21, *Impairment of Non-cash-generating Assets* and IPSAS 26, *Impairment of Cash-generating Assets* requires an impairment test if there is any indication that an asset is impaired. Thus, if a first-time adopter uses fair value as deemed cost for assets whose fair value is likely to be above cost, it cannot ignore indications that the recoverable amount or recoverable service amount of other assets may have fallen below their carrying amount.

BC83. The IPSASB also considered the circumstances under which a first-time adopter should be allowed to determine a deemed cost on initial adoption of IPSAS, or where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure certain assets. The IPSASB considered whether the use of a deemed cost should be restricted to those situations where cost information is not available for assets, or whether it should be allowed in all circumstances, irrespective of whether cost information is available on the date of adoption of IPSASs, or the date on which the asset is recognized and/or measured where a first-time adopter has taken advantage of the exemption that provides a three year transitional relief period to not recognize and/or measured certain assets.

BC84. The IPSASB agreed that, to avoid the selective valuation of assets, the use of a deemed cost should be restricted to those circumstances where reliable information about the historical cost of the asset is not available.

Deemed Cost for Investments in Controlled Entities, Joint Ventures or Associates

BC85. The IPSASB also agreed that a first-time adopter may elect to measure an investment in a controlled entity, joint venture or associate at cost in its separate financial statements on the date of adoption of IPSASs at either cost as determined in accordance with IPSAS 6, or deemed cost. Deemed cost is determined as fair value in accordance with IPSAS 41, *Financial Instruments*.

Deemed Cost for Intangible Assets

BC86. In considering whether a first-time adopter should be allowed to determine a deemed cost for intangible assets, the IPSASB considered the existing transitional provisions in IPSAS 31. IPSAS 31 allows a first-time adopter to use a previous revaluation of intangible assets at, or before, the date of transition as deemed cost at the date of the revaluation if the revaluation is broadly comparable to fair value or cost or depreciated cost that is adjusted to reflect for example, changes in a general or specific price index. IPSAS 31, however, only allows a first-time adopter to determine a deemed cost if the recognition criteria in IPSAS 31 (including the reliable measurement of original cost), and the criteria for revaluation (including the existence of an active market), have been met.

BC87. The IPSASB debated whether public sector entities will be likely to fulfil the second criterion on initial adoption of IPSAS, i.e. existence of an active market. The IPSASB acknowledged that it may be uncommon for an active market to exist in the public sector for intangible assets, and as a consequence, the use of the deemed cost approach will likely be considerably restricted. As a result, a first-time adopter may be unable to determine a deemed cost for some intangible assets such as in-house developed IT systems.

BC88. The IPSASB considered whether the reliable measurement of original cost should be required for first-time adopters which previously applied a cash basis of accounting, as some entities might find it cumbersome to identify the original cost of their intangible assets. It was also argued that where a first-time adopter has previously applied the accrual basis of accounting and it has acquired intangible assets through a non-exchange transaction, it might not be able to reliably measure original cost.

BC89. Based on these considerations, the IPSASB concluded that the reliable measurement of the original cost should be excluded as a criterion for the application of the deemed cost approach on first-time adoption of IPSASs.

BC90. The IPSASB therefore agreed that a first-time adopter is allowed to determine a deemed cost for intangible assets where that deemed costs meets: (a) the recognition criteria in IPSAS 31 (excluding the reliable measurement criterion) and (b) the criteria in IPSAS 31 for revaluation (including the existence of an active market).

BC91. In considering whether a first-time adopter should be allowed to determine a deemed cost for internally generated intangible assets, the IPSASB concluded that it would be difficult to retrospectively assess the probability of expected future economic benefits or service potential through reasonable and supportable assumptions as management would not be able to apply hindsight in obtaining such information. Due to the absence of reliable information on the date of adoption of IPSASs, it was therefore agreed that a deemed cost may not be determined for internally generated intangible assets.

Alternative Measurement Bases for Fair Value in Determining Deemed Cost

BC92. The IPSASB considered whether some revaluations in accordance with a first-time adopter's previous basis of accounting might be more relevant to users than original cost. It was concluded that it would not be reasonable to require a time-consuming and expensive estimation of cost, if previous revaluations already comply with IPSASs. This IPSAS therefore allows a first-time adopter to use a revaluation under its previous basis of accounting for property, plant and equipment determined at or before the date of adoption of IPSASs, as deemed cost. This may be used if the revaluation is, at the date of the revaluation, broadly comparable to:

(a) Fair value; or

(b) Cost or depreciated cost, where appropriate, in accordance with IPSASs adjusted to reflect, for example, changes in a general or specific price index.

BC93. In determining "fair value", the guidance in each applicable IPSAS is considered, where such guidance is provided. In IPSAS 17 it is noted that fair value is normally determined by reference to market-based evidence, often by appraisal. IPSAS 17 also states that if market based evidence is not available to measure items of property, plant and equipment, an entity can estimate fair value using replacement cost, reproduction cost or a service units approach.

BC94. The IPSASB noted that the fair value guidance in IPSAS 16 only considers a market-based value, and that limited guidance is provided in IPSAS 12 in determining fair value. The IPSASB concluded that because a first-time adopter may find it difficult to determine a market-based fair value for all investment properties and all inventories, other measurement alternatives may need to be considered in determining deemed cost for inventory or investment property.

BC95. The IPSASB agreed that a first-time adopter may consider the following measurement alternatives in determining a deemed cost if reliable market-based evidence of fair value is not available on the date of adoption of IPSASs, or on the date that the asset is recognized and/or measured where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure certain assets:

(a) For inventory, current replacement cost; and

(b) For investment property of a specialized nature, depreciated replacement cost.

Determining a Deemed Cost Where the First-Time Adopter has Taken Advantage of the Three Year Transitional Exemption Period

BC96. The IPSASB concluded that, to the extent that a first-time adopter has elected to adopt one or more of the transitional exemptions that provides relief for the recognition and/or measurement of assets, it may not be able to retrospectively adjust the value of the asset to the date of adoption of accrual basis IPSASs. Retrospectively adjusting the value of the asset would require consideration of the price of the asset and other market factors that existed on the date of adoption of accrual basis IPSASs, including whether there was any indication that the asset was impaired.

BC97. The IPSASB concluded that this would not be cost effective. It was therefore agreed that, where a first-time adopter takes advantage of the exemption which allows a three year transitional relief period to not recognize and/or measure an asset, it may determine a deemed cost for that asset at any point of time within the three year transitional relief period. Any adjustments resulting from the recognition of the asset are recognized against the opening accumulated surplus or deficit in the year in which asset is recognized and/or measured.

IPSAS 18, Segment Reporting

BC98. The IPSASB considered whether relief should be provided to a first-time adopter for the presentation of segment information. The IPSASB agreed that, despite the fact that the presentation of segment information might be useful, a first-time adopter should be provided a relief period, as the information used in presenting segment information needs to be built on existing information in the financial statements.

BC99. As the IPSASB agreed to allow a three year transitional relief period for the recognition and/or measurement of assets and liabilities, the information which is needed to present segment information may only be available when the exemptions that provided the relief have expired, or when the relevant items are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier). As relevant and reliable information may not be available to present a meaningful segment report during the period of transition, and because the presentation of a segment report may not be a priority for users during the transition to accrual basis IPSASs it was agreed that a three year exemption period should also be provided for the presentation of segment information.

BC100. The IPSASB also concluded that, because segment information is additional to the information required on the elements presented in the financial statements, allowing this relief is appropriate.

IPSAS 20, Related Party Disclosures

BC101. In providing a first-time adopter time to build up information on its related party relationships and related party transactions, the IPSASB agreed that the disclosure of related party relationships, related party transactions and information about key management personnel should be treated in the same way as the required eliminations of balances, transactions, revenue and expenses between entities in IPSAS 6 to 8.

BC102. This IPSAS therefore provides a transitional exemption for a period of three years for the disclosure of related party relationships, related party transactions and information about key management personnel.

IPSAS 21, Impairment of Non-Cash-Generating Assets and IPSAS 26, Impairment of Cash-Generating Assets

BC103. The IPSASB acknowledged that a first-time adopter may have applied an accounting policy for the recognition and reversal of impairment losses that are different to the requirements in IPSAS 21 and 26, or may have not considered impairment at all. On adoption of IPSASs, it may be difficult to determine the amount of adjustments resulting from retrospective application of a change in an accounting policy, as this requires hindsight.

BC104. As a result, the IPSASB agreed that IPSAS 21 and 26 should be applied prospectively, but that the first-time adopter should be required to assess whether an indicator of impairment has been triggered for its cash-generating and non-cash-generating assets in the opening statement of financial position.

BC105. In recognizing the effect of an impairment loss on first-time adoption of IPSAS 21 or IPSAS 26, the IPSASB considered two options. The first option was to measure such assets at their recoverable amount, or recoverable service amount and use that as the deemed cost. The IPSASB noted that the effect of applying this option may means that impairment losses could not be reversed in the future. This option was therefore not seen as appropriate.

BC106. The second option, which provides more relevant information is to measure the assets at their recoverable amount, or recoverable service amount, and report the effect in net assets/equity. The IPSASB supported this option.

Timing of Impairment Test for Assets Where an Entity Adopts the Relief Period for the Recognition of Assets

BC107. The IPSASB concluded that where a first-time adopter takes advantage of the exemption that provides relief for the recognition and/or measurement of assets, it may be difficult to retrospectively adjust the value of the asset to the date of adoption of IPSASs. A first-time adopter may find it difficult to determine the amount of adjustments that would be required based on impairment that may or may not have existed at the date of transition.

BC108. The IPSASB therefore agreed that IPSAS 21 and IPSAS 26 should be applied prospectively from the date when the transitional exemptions that provided the relief have expired, or when the relevant asset is recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier).

IPSAS 39, Employee Benefits

BC109. In developing IPSAS 33, the IPSASB also agreed that, where a first-time adopter took advantage of the exemptions that provide relief for the recognition and/or measurement of liabilities, it should provide information about amounts for the current and previous four annual periods of the present value of the defined benefit obligation, the fair value of the plan assets, and the surplus or deficit in the plan and adjustments as required by IPSAS 25 prospectively. IPSAS 39, *Employee Benefits*, was issued in July 2016. IPSAS 39 deleted paragraph 107 of this Standard as the requirement in paragraph 141(p) of IPSAS 25 to disclose information on experience adjustments was not adopted in IPSAS 39.

IPSAS 28, Financial Instruments: Presentation

BC110. IPSAS 28 requires an entity to split a compound financial instrument at inception of the agreement, into separate liability and equity components. It was concluded that separating these two portions would be costly and would not provide relevant information to users of financial statements if the liability component of the compound instrument is no longer outstanding at the date of adoption of IPSASs. As a result, this IPSAS requires that, if the liability component is no longer outstanding at the date of adoption of IPSAS, the first-time adopter need not separate the cumulative interest on the liability component from the net assets/equity component.

IPSAS 41, Financial Instruments

BC111. The IPSASB concluded that, as it is in most instances impracticable to apply impairment principles retrospectively, the impairment of financial instruments should be applied prospectively. This exemption is consistent with the exemption provided for non-cash-generating assets and cash-generating assets in accordance with IPSAS 21 and 26.

IPSAS 30, Financial Instruments: Disclosures

BC112. The IPSASB concluded that if a first-time adopter did not disclose information relating to financial instruments, and the nature and extent of risks arising from financial instruments under its previous basis of accounting, obtaining such information may be costly, and therefore is not feasible.

BC113. The IPSASB therefore agreed that the disclosure requirements relating to financial instruments should be applied prospectively from the date of adoption of IPSAS, or where the first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure financial assets, when the exemptions expire, or when the relevant items are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier).

BC114. To the extent that a first-time adopter elects to present comparative information, it was agreed that a first-time adopter need not present comparative information for disclosures relating to the nature and extent of risks arising from financial instruments for the comparative period because obtaining such information may be costly, and is therefore not feasible.

IPSAS 31, Intangible Assets

BC115. On first-time adoption of IPSASs, a first-time adopter will be required to recognize all assets and liabilities for which recognition is required by IPSASs. IPSAS 31 requires that past expenditure on an intangible asset that was initially recognized as an expense should not be recognized as part of the cost of an intangible asset at a later date.

BC116. The IPSASB concluded that, because a first-time adopter may have expensed costs incurred on intangible assets under its previous basis of accounting prior to the adoption of IPSASs, a first-time adopter should be allowed to recognize all intangible assets that meet the recognition criteria and other criteria in IPSAS 31 (i.e., identifiable control of an asset and that future economic benefits or service potential that are attributable to the asset will flow to the entity), even though such costs may have been expensed prior to adoption of IPSASs. It was however, confirmed that such assets should only be recognized as intangible assets if reliable cost information is available and an active market exists for that asset on the date of adoption of IPSASs.

Interests in Other Entities

BC117. The IPSASB considered whether IPSAS 33 should refer to IPSAS 6, *Consolidated and Separate Financial Statements*, IPSAS 7, *Investments in Associates,* and IPSAS 8, *Interests in Joint Ventures,* as well as IPSAS 34, *Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements*, and IPSAS 36, *Investments in Associates and Joint Ventures*, which were published in January 2015 with an effective date of January 1, 2017, with early adoption permitted. The IPSASB noted that as IPSAS 33 was published in January 2015, any entity adopting IPSAS 33 and electing to apply the 3 year exemptions, would be required to apply IPSASs 34–36 by the time the transitional period is complete. The IPSASB formed a view that it was very unlikely that entities adopting IPSAS 33, prior to January 1, 2017, would adopt IPSASs 6–8 as this would require a further transition to IPSAS 34–36 shortly afterwards. The IPSASB therefore concluded that IPSAS 33 should not include provisions relating to IPSASs 6-8.

Revision of IPSAS 33 as a result of the IPSASB's *The Applicability of IPSASs*, issued in April 2016

BC118. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:

(a) Removes the standard paragraphs about the applicability of IPSASs to "public sector entities other than GBEs" from the scope section of each Standard;

(b) Replaces the term "GBE" with the term "commercial public sector entities", where appropriate; and

(c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.

Revision of IPSAS 33 as a result of *Improvements to IPSAS, 2018*

BC119. Following the issue of IPSAS 33, the IPSASB became aware that stakeholders were uncertain whether the exemption from providing comparative information applied to the first financial statements issued following the adoption of accrual basis IPSAS, or all financial statements issued during the transition period. Paragraph 77 referred to an entity's 'first transitional IPSAS financial statements' whereas other paragraphs referred to an entity's 'transitional IPSAS financial statements.' The IPSASB agreed to amend the other paragraphs to clarify that the exemption applies only to the first financial statements issued following the adoption of accrual basis IPSAS.

BC120. The IPSASB reviewed the requirements of IFRIC 22, *Foreign Currency Transactions and Advance Consideration*, issued by the IASB in December 2016, and the considerations of the IFRS Interpretations Committee in reaching its consensus as set out in its Basis for Conclusions. The IPSASB generally concurred that there was no public sector specific reason for not incorporating these requirements into IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*. Consequently, the IPSASB agreed to incorporate the requirements of IFRIC 22 into Appendix A of IPSAS 4. The IPSASB noted that entities are permitted to apply the requirements of Appendix A prospectively, and therefore agreed that first-time adopters need not apply the requirements to assets, expenses and revenue in the scope of Appendix A initially recognized before the date of adoption of IPSAS.

Revision of IPSAS 33 as a result of *Improvements to IPSAS, 2019*

BC121. The amendments to paragraphs 113, 113A and 114 update the guidance on classifying financial instruments on initial adoption of accrual basis IPSAS resulting from IPSAS 41, *Financial Instruments* which were inadvertently omitted when IPSAS 41 was issued. The IPSASB agreed to include these minor amendments in *Improvements to IPSAS, 2019.*

Revision of IPSAS 33 as a result of *COVID-19: Deferral of Effective Dates*

BC122. The IPSASB published *Improvements to IPSAS*, *2019* in January 2020, which included amendments to IPSAS 33: *First-Time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)*. At the time these amendments were finalized, the Board decided that an entity shall apply them for annual financial statements covering periods beginning on or after January 1, 2022.

BC123. In June 2020, the IPSASB discussed the effect of the COVID-19 pandemic on financial reporting. The Board noted that the pandemic has created significant pressures on the resources public sector entities might otherwise allocate to the implementation of these amendments.

BC124. The Board concluded that deferral during a time of significant disruption would provide much-needed operational relief to public sector entities. Therefore, the Board decided to propose a one-year deferral of the effective date of these amendments.

BC125. The Board did not propose any changes to the amendments other than the deferral of the effective date. Earlier application of the amendments will continue to be permitted.

Revision of IPSAS 33 as a result of *Improvements to IPSAS, 2021*

BC126. The IPSASB reviewed the revisions to IFRS 1, *First-time Adoption of International Financial Reporting Standards, included in Annual Improvements to IFRS® Standards* (2018-2020) issued by the IASB in May 2020, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions and concurred that there was no public sector specific reason for not adopting these amendments.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 33.

IG1. The purpose of this Implementation Guidance is to illustrate certain aspects of the requirements of IPSAS 33.

Date of Adoption of IPSASs

IG2. The date of adoption of IPSASs is the date an entity adopts accrual basis IPSAS for the first time in preparing its financial statements.

IG3. Prior to the adoption of this IPSAS, a first-time adopter shall have adequately prepared for its transition to accrual basis IPSASs. The guidance provided in Study 14, *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities* issued by the IPSASB, may assist a first-time adopter with planning the conversion to accrual basis IPSASs. The relief provided in this IPSAS shall therefore not be seen as a complete roadmap for the adoption of accrual basis IPSASs, but rather the end stage of the adoption process.

IG4. A first-time adopters' date of adoption will therefore to be the start of the reporting period in which it elects to adopt accrual basis IPSASs for which it presents its transitional IPSAS financial statements or its first IPSAS financial statements. For example, an entity elects to adopt accrual basis IPSASs from January 1, 20X1 for its reporting period ending December 31,20X1. The date of adoption of IPSASs will be January 1, 20X1.

Transitional IPSAS Financial Statements

IG5. On the date of adoption of IPSASs, a first-time adopter may elect to adopt one or more of the exemptions included in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs).* Some of the exemptions included in IPSAS 33 affect the fair presentation of a first-time adopter's financial statements and its ability to assert compliance with accrual basis IPSASs (Appendix A lists the transitional exemptions and provisions that a first-time adopter is required to apply and/or can elect to apply on adoption of accrual basis IPSASs and illustrates whether fair presentation and the first-time adopter's ability to assert compliance with accrual basis IPSASs will be affected).

IG6. As a first-time adopter is not able to make an explicit and unreserved statement of compliance with accrual basis IPSASs following the adoption of the exemptions provided in IPSAS 33, the financial statements presented for the first reporting period following the adoption of accrual basis IPSASs, will be referred to as the "transitional IPSAS financial statements".

IG7. For example, if the first-time adopter adopts the transitional exemption that provides relief for the recognition of certain items of property, plant and equipment when adopting accrual basis IPSASs on January 1, 20X1, it would not be able to make an explicit and unreserved statement of compliance with accrual basis IPSASs at the end of its first reporting period, i.e. December 31, 20X1. The financial statements prepared for the first reporting period, will therefore be referred to as the "first transitional IPSAS financial statements".

IG8. The financial statements presented during the period of transition until the exemptions that provided the relief have expired, and/or when the relevant items are recognized and/or measured in the financial statements in accordance with the applicable IPSASs, will be referred to as the "transitional IPSAS financial statements".

Basis of Preparation When Preparing Transitional IPSAS Financial Statements

IG9. As stated in paragraph 27 of IPSAS 33, a first-time adopter that elects to adopt one or more of the exemptions included in IPSAS 33, may not be able to make an explicit and unreserved statement of compliance with accrual basis IPSASs as required by IPSAS 1. During the period of transition, this fact shall be highlighted to the users of financial statements in presenting the "basis of preparation" in the financial statements.

IG10. As an illustration, if a first-time adopter elected to adopt the transitional exemption that allows it three years in which to recognize and/or measure investment property, the following explanation may be provided in the "basis of preparation" paragraph in the financial statements during the period of transition:

Basis of preparation

The financial statements have been prepared in accordance with accrual basis International Public Sector Accounting Standards (IPSASs). IPSAS 33 allows a first-time adopter a period of up to three years to recognize and/or measure certain assets and/or liabilities.

In its transition to accrual basis IPSASs, Public Sector Entity X took advantage of this transitional exemption for investment property. As a result, it is unable to make and explicit an unreserved statement of compliance with accrual basis IPSASs in preparing its transitional IPSAS financial statements for this reporting period. Public Sector Entity X intends to recognize and/or measure its investment property by 20X3.

First IPSAS Financial Statements

IG11. A first-time adopter's first IPSAS financial statements will be the first set of financial statements that it presents in which it makes an explicit and unreserved statement of compliance with accrual basis IPSASs.

IG12. A first-time adopter will not be able to prepare its first IPSAS financial statements until the exemptions in IPSAS 33 that provided relief which affected fair presentation and compliance with IPSAS, have expired, or when the relevant items are recognized, measured and/or the relevant information has been presented and/or disclosed in accordance with the applicable IPSASs (whichever is earlier).

IG13. Following from the example in IG5, the transitional exemptions that provided the relief for the recognition of certain items of property, plant and equipment expire after three years, i.e. December 31, 20X3. If it is assumed that the entity has not adopted any other transitional exemptions in IPSAS 33 that affect fair presentation and compliance with IPSASs, and that it recognizes and/or measures the items of property, plant and equipment during the transitional period, a first-time adopter will present its first IPSAS financial statements for the period ending December 31, 20X3.

IG14. If a first-time adopter has not adopted any of the exemptions in IPSAS 33 that affect fair presentation and its ability to claim compliance with accrual basis IPSASs, its first accrual financial statements will also be its first IPSAS financial statements.

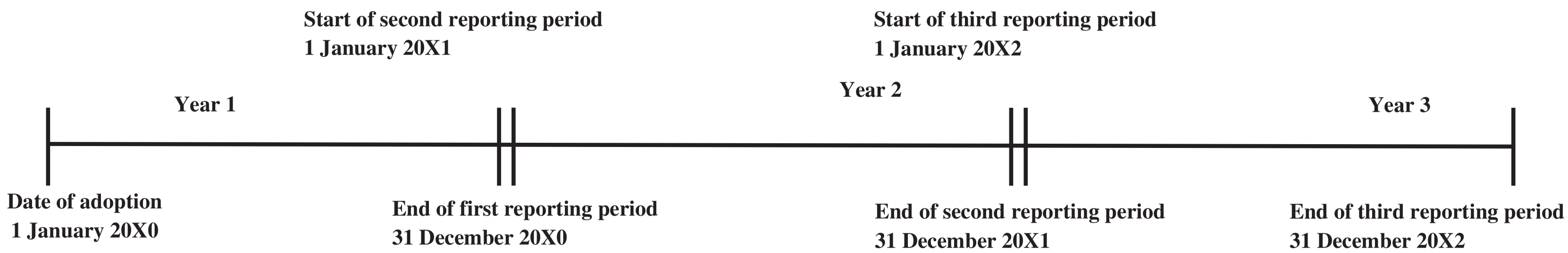
To illustrate:

Timeline – First Time Adoption IPSAS (assuming that entity elects to apply the three year transitional relief for the recognition and/or measurement of certain assets)

An entity adopts accrual basis IPSASs on 1 January 20X0 by applying IPSAS 33, *First Time Adoption of Accrual Basis IPSASs*

The first-time adopter elects to apply the three year relief for the recognition of property, plant and equipment. Assume that it does not adopt of any other relief periods. It also elects not to present comparative information.

The first-time adopter recognizes all property, plant and equipment by 31 December 20X2.



<u>Year 1 (ending 31 December 20X0) – First Transitional IPSAS Financial Statements</u>
Cannot assert compliance with accrual basis IPSASs

Present the following statements:
*opening statement of financial position as at 01/01/20X0
*statement of financial position as at 31/12/20X0
*statement of financial performance for 31/12/20X0
*statement of changes in net assets as at 31/12/20X0
*cash flow statement for 31/12/20X0
*statement of comparison of budget and actual information for 31/12/20X0
(depending on the policy chosen for presentation of information the first-time adopter may include an additional column in the annual financial statements)

Present the following in the notes:
*reconciliation of changes from its previous basis of accounting (reflect adjustments related to the adoption of all IPSASs besides IPSAS 17)

Note: If the first-time adopter elected to present comparative information, the following statements shall have been presented:
*opening statement of financial position as at 01/01/19X0
*statement of financial position as at 31/12/19X0 and 31/12/20X0
*statement of financial performance for 31/12/10X0 and 31/12/20X0
*statement of changes in net assets as at 31/12/19X0 and 31/12/20X0
*cash flow statement for 31/12/19X0 and 31/12/20X0
*statement of comparison of budget and actual information for 31/12/19X0 and 31/12/20X0

<u>Year 2 (ending 31 December 20X1) – Transitional IPSAS Financial Statements</u>
Cannot assert compliance with IPSASs

Present the following statements for <u>both</u> 31/12/20X1 <u>and</u> 20X0:
*statement of financial position
*statement of financial performance
*statement of changes in net assets
*cash flow statement

Present the statement of comparison of budget and actual information for 31/12/20X1 <u>only</u> (depending on policy chosen for presentation of information the first-time adopter may include an additional column in the annual financial statements)

<u>Year 3 (ending 31 December 20X3) – First IPSAS Financial Statements</u>
Can assert compliance with IPSASs

Present the following statements for <u>both</u> 31/12/20X2 <u>and</u> 20X1:
*statement of financial position
*statement of financial performance
*statement of changes in net assets
*cash flow statement

Present the statement of comparison of budget and actual information for 31/12/20X2 <u>only</u> (depending on policy chosen for presentation of information, the first-time adopter may include an additional column in the annual financial statements)

Present the following in the notes:
*reconciliation of adjustments made to recognize property, plant and equipment

Estimates

IG15. Paragraph 23 of IPSAS 33 requires that a first-time adopter's estimates in accordance with IPSASs at the date of adoption of IPSASs shall be consistent with estimates made at the end of its comparative period in accordance with the previous basis of accounting (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error. An entity may receive information after the date of adoption of IPSASs about estimates that it had made under the previous basis of accounting. In accordance with paragraph 24, a first-time adopter shall treat the receipt of that information in the same way as non-adjusting events after the reporting period in accordance with IPSAS 14, *Events after the Reporting Period*.

IG16. For example, assume that a first-time adopter's date of adoption of IPSASs is January 1, 20X4 and new information on July 15, 20X4 requires the revision of an estimate made in accordance with the previous basis of accounting at December 31, 20X3. The first-time adopter shall not reflect that new information in its opening statement of financial position (unless the estimates require adjustment for any differences in accounting policies or there is objective evidence that the estimates were in error). Instead, the first-time adopter shall reflect that new information in surplus or deficit for the year ended December 31, 20X4.

Transitional Exemptions that Provide Three Year Relief for the Recognition and/or Measurement of Assets and/or Liabilities

IG17. IPSAS 33 provides a first-time adopter a period of up to three years' relief in which it is allowed to not recognize and/or measure certain assets and liabilities. Where a first-time adopter takes advantage of this exemption, it will have to consider and analyze title deeds, contracts and other similar arrangements in accounting for, and classifying these assets in accordance with the applicable IPSAS.

IG18. For example, assume that a first-time adopter controls a wide range of property, plant and equipment when it adopts accrual basis IPSASs on January 1, 20X1. If the first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure the property, plant and equipment, it may recognize and/or measure the property, plant and equipment during the period of transition from January 1, 20X1 until December 31, 20X3. If the property, plant and equipment is recognized for example, on April 1, 20X2, the first-time adopter shall adjust the opening accumulated surplus or deficit on January 1, 20X2. As required by paragraph 142 of IPSAS 33, the first-time adopter shall, as part of the notes to the financial statements, provide a reconciliation to the accumulated surplus or deficit as at December 31, 20X1 (i.e. the opening balance as at January 1, 20X2) for the property, plant and equipment that was recognized on April 1, 20X2.

IG19. Where a first-time adopter has taken advantage of the three year relief period, it shall not derecognise any of the assets and/or liabilities that were recognized under its previous basis of accounting unless it is to comply with an IPSAS requirement. Any adjustments to the assets and/or liabilities recognized under its previous basis of accounting shall be adjusted during the period of transition against the opening accumulated surplus of deficit in the period in which the adjustment is made.

Accounting for Leases

IG20. Where a first-time adopter that is a lessee takes advantage of the exemption that provides a three year transitional relief period to not recognize its right-of-use assets, it will also not be able to comply with the recognition requirements relating to the lease liabilities, until the transitional exemptions related to the right-of-use assets have expired.

IG21. For example, assume that a first-time adopter that is a lessee has a right-of-use asset as a result of a lease contract on the date of adoption of accrual basis IPSASs on January 1, 20X1. The first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize the right-of-use asset. The right-of-use asset is recognized on December 31, 20X3 when the exemption expires. IPSAS 33 requires the first-time adopter to only recognize the corresponding lease liability for the right-of-use asset on December 31, 20X3, i.e. on the date that the right-of-use asset is recognized.

Recognition of Provisions Included in the Initial Cost of an Item of Property, Plant and Equipment

IG22. IPSAS 17 recognizes that in some cases, the construction or commissioning of an item of property, plant and equipment will result in an obligation for an entity to dismantle or remove the item of property, plant and equipment and restore the site on which the asset is located. An entity is required to apply IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* in recognizing and measuring the resulting provision to be included in the initial cost of the item of property, plant, and equipment.

IG23. IPSAS 33 provides an exemption for the recognition of this liability. A first-time adopter is allowed to not recognize and/or measure the liability relating to the initial estimate of costs of dismantling and removing the item and restoring the site on which it is located, until such time as the exemption for IPSAS 17 expires and/or the relevant asset is recognized and/or measured and relevant information has been presented and/or disclosed in the financial statements in accordance with IPSAS 17 (whichever is earlier).

IG24. For example, an entity adopts accrual basis IPSASs on January 1, 20X1 and takes advantage of the exemption in IPSAS 33 that provides a three year transitional relief period to not recognize a government owned nuclear power station. The first-time adopter determines a deemed cost for the asset on June 30, 20X3 and recognizes the asset on that date at CU1,000,000. The first-time adopter determines that it has a decommissioning obligation under IPSAS 19 of CU500,000 at the date of adoption of IPSASs. The obligation amounts to CU550,000 on June 30, 20X3 when the asset is recognized.

IG25. IPSAS 33 requires the first-time adopter to only recognize and/or measure its obligation relating to the dismantling and restoring of the site on June 30, 20X3, i.e. the date on which the asset is recognized. The liability will be measured at CU550,000 which reflects the first-time adopter's obligation on the date that the asset is recognized. The first-time adopter shall, as part of the notes to the financial statements, provide a reconciliation to the accumulated surplus or deficit as at December 31, 20X2 (i.e. the opening balance as at January 1, 20X3) for the recognition of the obligation and the related asset that was recognized on June 30, 20X2.

Borrowing Costs Incurred on Qualifying Assets

IG26. Paragraph 90 of IPSAS 33 requires that, where a first-time adopter elects to account for borrowing costs in accordance with the allowed alternative treatment, it is required to apply the requirements in IPSAS 5, *Borrowing Costs* retrospectively, for any borrowing costs incurred on qualifying assets before the date for adoption of IPSASs.

IG27. Paragraph 44 of IPSAS 33 provides an exemption to this requirement by allowing a first-time adopter to commence capitalization of borrowings costs incurred on qualifying assets after the recognition of an asset where the first-time adopter takes advantage of the exemption that provides a three year transitional relief period for the recognition of assets.

IG28. For example, a first-time adopter adopts the allowed alternative treatment in accounting for borrowing costs incurred on qualifying assets. The date of adoption of IPSASs is January 1, 20X1. The first-time adopter determines that the borrowing cost incurred prior to the adoption of IPSASs on January 1, 20X1 amounts to CU500,000 and that borrowing costs incurred at the end following two reporting periods amounted to CU20,000 and CU30,000. In addition, the first-time adopter adopts the exemption that provides three year transitional relief from the recognition of property, plant and equipment and as a result, recognizes the item of property, plant and equipment at the end of the second reporting period at CU1,000,000.

At the end of 20X2, the item of property, plant and equipment recognized on the statement of financial position will be CU1,030,000 (CU1,000,000 + CU30,000). Borrowing costs incurred prior to the recognition of the item of property, plant and equipment, i.e. CU500,000 and CU20,000 shall not be included as part of the cost of the qualifying asset.

Presenting Comparative Information

IG29. Paragraph 78 of IPSAS 33 encourages, but does not require an entity to present comparative information in its first transitional IPSAS financial statements or its first IPSAS financial statements in accordance with this IPSAS. The decision to present comparative information affects not only the extent of the information presented, but also the date of adoption of IPSASs.

Date of Adoption of IPSASs

IG30. To illustrate: The end of a first-time adopter's first accrual basis reporting period is December 31, 20X5. The first-time adopter decides to present comparative information in those financial statements for one year only (see paragraph 78 of IPSAS 33). Therefore, its date of adoption of IPSASs is the beginning of the comparative period i.e. January 1, 20X4 (or equivalently December 31, 20X3).

Information Presented when a First-Time Adopter Elects to Prepare Comparative Information

IG31. Where the first-time adopter elects to prepare comparative information, it is required to apply the accrual basis IPSASs effective for periods ending on December 31, 20X5 in:

(a) Preparing and presenting its opening accrual basis statement of financial position at January 1, 20X4; and

(b) Preparing and presenting its:

   (i) Statement of financial position for December 31, 20X5 (including comparative amounts for 20X4);

   (ii) Statement of financial performance (including comparative amounts for 20X4);

(iii) Statement of changes in net assets/equity for December 31, 20X5 (including comparative amounts for 20X4);

(iv) Statement of cash flows for the year to December 31, 20X5 (including comparative amounts for 20X4);

(v) Disclosures (including comparative information for 20X4);

(vi) A comparison of budget and actual amounts for the year to December 31, 20X5; and

(vii) Reconciliations in accordance with paragraph 142.

First-Time Adopter Elects to Not Prepare Comparative Information

IG32. Where a first-time adopter elects to not prepare comparative information, it is required to apply the accrual basis IPSAS effective for periods ending on December 31, 20X5:

(a) Preparing and presenting its opening accrual basis statement of financial position at 1 January 20X5; and

(b) Preparing and presenting its:

(i) Statement of financial position for December 31, 20X5;

(ii) Statement of financial performance for December 31, 20X5;

(iii) Statement of changes in net assets/equity for December 31, 20X5;

(iv) Statement of cash flows for the year to December 31, 20X5;

(v) Disclosures;

(vi) A comparison of budget and actual amounts for the year to December 31, 20X5; and

(vii) Reconciliations in accordance with paragraph 142.

Adoption of Three Year Transitional Relief Period

IG33. Where the first-time adopter takes advantage of the exemptions that provide relief from the recognition and/or measurement of assets and/or liabilities, IPSAS 33 requires it to only adjust comparative information for reporting periods following the date of adoption of IPSASs to the extent that reliable and relevant information is available about the items that have been recognized and/or measured.

IG34. To illustrate: The end of a first-time adopter's first accrual basis reporting period is December 31, 20X2. The first-time adopter on the date of adoption of IPSASs on January 1, 20X1, adopts the transitional exemption providing a three year relief period for the recognition of investment property. At the end of 20X3 the first-time adopter has recognized the investment property, which is included in the statement of financial position as at December 31, 20X3. Only if reliable and relevant information is available about the value of the investment property recognized during 20X3, will the first-time adopter adjust the comparative information presented (i.e., for the period ending December 31, 20X2).

Presenting Reconciliations

IG35. Paragraph 142 of IPSAS 33 requires a first-time adopter to present a reconciliation of its closing balances reported under its previous basis of accounting, to its net assets/equity in accordance with IPSASs for its first transitional IPSAS financial statements or its first IPSAS financial statements. A reconciliation is also presented of its accumulated surplus or deficit in accordance with its previous basis of accounting to its accumulated surplus or deficit at the date of adoption of IPSASs.

IG36. For example, a first-time adopter, which previously applied a modified-accrual basis of accounting, adopts accrual basis IPSASs on January 1, 20X4 and elects to present comparative information as permitted in IPSAS 33. The first-time adopter shall, in accordance with paragraphs 142 and 143 of IPSAS 33, present a reconciliation in the notes to its transitional IPSAS financial statements that provides sufficient detail to enable users to understand the material adjustments to the opening statement of financial position as at January 1, 20X4, and the restated comparative statement of financial performance, where applicable.

IG37. Paragraph 146 further requires a first-time adopter that takes advantage of the exemptions that provide a three year transitional relief period to not recognize and/or measure items, to present a reconciliation of items that have been recognized and/or measured during the reporting period which were not recognized and/or measured in the previous financial statements.

IG38. Following from the example in IG29, a first-time adopter adopts the exemption in IPSAS 33 that allows it to not recognize investment property for a period of three years. The first-time adopter applies this exemption and only recognizes the investment property at the end of year three, i.e. December 31, 20X4. As an adjustment is made to the opening balance of accumulated surplus or deficit as on January 1, 20X4 in recognizing the investment property, paragraph 146 requires the first-time adopter to present a reconciliation in its notes to the financial statements for the year ending December 31, 20X4 to allow users to understand the adjustment that was made following the recognition of the investment property.

Deemed Cost

IG39. IPSAS 33 allows a first-time adopter to determine a deemed cost as a substitute for acquisition cost or depreciated cost at the date of adoption of IPSASs, where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure certain assets and/or liabilities. A deemed cost may however only be determined if no cost information is available about the historical cost of the asset and/or liability. When a first-time adopter initially measures these assets and/or liabilities on the date of adoption of IPSASs, or when the transitional exemptions that provided the first-time adopter with a three year relief period to not recognize and/or measure certain assets and/or liabilities have expired, it recognizes the effect directly in accumulated surplus or deficit in the opening statement of financial position in the period in which the deemed cost is determined.

To illustrate:

Public Sector Entity X adopted accrual basis IPSAS on January 1, 20X4 and applied deemed cost to measure investment property. In applying deemed cost, investment property was valued at CU 1,800,000 on the date of adoption. Public Sector Entity X elected to not present comparative information.

Statement of Changes in Net Assets/Equity for the Year ended December 31, 20X4

	Attributable to owners of the controlling entity		Total net assets/equity
	Accumulated surplus/ deficit CU	Other Reserves CU	CU
Opening balance as at January 1, 20X4	210,000	10,000	220,000
Measurement of investment property at deemed cost in accordance with IPSAS 33 (see note 34)	1,500,000		1,500,000
Restated opening balance as at January 1, 20X4	1,710,000	10,000	1,720,000
Surplus for the period	5,000		5,000
Balance as at December 31, 20X4	1,715,000	10,000	1,725,000

Notes to the financial statements of Public Sector Entity X as at December 31, 20X4:

Note 34 – Investment Property

	December 31, 20X4CU
Opening balance of investment property recognized under previous basis of accounting	300,000
Investment property measured at deemed cost as provided in IPSAS 33 on January 1, 20X4	1,500,000
Restated opening balance of investment property at January 1, 20X4	1,800,000
Additions	…….

Transitional exemptions adopted in IPSAS 33 on adoption of accrual basis IPSASs

Public Sector Entity X adopted accrual basis IPSAS on January 1, 20X4 and applied deemed cost in measuring investment property as reliable cost information about some investment properties was not available. As a result, Public Sector Entity X restated its opening balance of investment property with an additional value of CU1,500,000 on January 1, 20X4.

Note 54 – Reconciliation of net assets/equity and surplus or deficit on January 1, 20X4

Reconciliation of net assets/equity as on January 1, 20X4

	Net assets/equity as on January 1, 20X4
	CU
Opening balance of net assets/equity as on January 1, 20X4 reported under previous basis of accounting	*220,000*
Recognition of investment property at deemed cost (see note 34)	*1,500,000*
Restated opening balance of net assets/equity as on January 1, 20X4	***1,720,000***

Reconciliation of surplus or deficit on January 1, 20X4

	Surplus or deficit on January 1, 20X4
	CU
Surplus or deficit as at 31, December 20X3 as reported under previous basis of accounting	*210,000*
Recognition of investment property at deemed cost (see note 34)	*1,500,000*
Restated surplus or deficit as on January 1, 20X4	***1,710,000***

Determining a Deemed Cost During the Period of Transition

IG40. If a first-time adopter takes advantage of the exemption in IPSAS 33 that provides a three year transitional relief period to not recognize and/or measure an asset, the IPSAS requires that it may determine a deemed cost for that asset during any point of time within the three year transitional relief period.

IG41. Subsequent depreciation and amortization, if applicable, is based on that deemed cost and starts from the date of adoption of IPSASs, or when the transitional exemptions that provided the relief have expired, or when the relevant items are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier).

IG42. For example, a first-time adopter adopts IPSASs on January 1, 20X1 and adopts the exemption that provides a three year transitional relief period for the recognition of an investment property. Because the first-time adopter does not have reliable cost information about the historical cost of the investment property on the date of adoption of IPSASs it decides to determine a deemed cost for the investment property. The deemed cost for the investment property is determined during the second reporting period (i.e. 20X2) in which the first-time adopter applies the exemption. IPSAS 33 allows the first-time adopter to use the deemed cost determined during 20X2 in recognizing the investment property by adjusting the opening accumulated surplus and deficit on January 1, 20X2. The deemed cost as determined on January 1, 20X2 will be used in determining subsequent depreciation and in assessing impairment where the first-time adopter elects to apply the cost model as its subsequent measurement basis in applying IPSAS 16.

IPSAS 5, Borrowing Costs

IG43. An entity adopts the accrual basis IPSASs on January 1, 20X3 and adopts the allowed alternative treatment in accounting for borrowing costs. Borrowing costs directly attributable to the acquisition of the asset amounts to CU525,000, of which CU500,000 was incurred prior to the adoption of accrual basis IPSASs, while CU25,000 was incurred in the first reporting period ending December 31, 20X3. Paragraph 90 of IPSAS 33 requires the first-time adopter to retrospectively recognize any borrowing costs incurred prior to the adoption of accrual basis IPSASs when it adopts the allowed alternative method. Therefore, CU500,000 shall be capitalized to the cost of the asset recognized in the opening statement of financial position as at January 1, 20X3.

IG44. If the entity has elected to apply the benchmark treatment, paragraph 88 of IPSAS 33 encourages, but does not require, the first-time adopter to apply the accounting policy retrospectively. If the first-time adopter elects to apply its accounting policy prospectively, it will only expense CU25,000 in the statement of financial performance for the period ending December 31, 20X3.

IPSAS 9, Revenue from Exchange Transactions

IG45. If a first-time adopter has received amounts that do not yet qualify for recognition as revenue in accordance with IPSAS 9 (for example, the proceeds of a sale that does not qualify for recognition as revenue), the first-time adopter recognizes the amounts received as a liability in its opening statement of financial position and measures that liability at the amount received. It shall derecognize the liability and recognize the revenue in its statement of financial performance when the recognition criteria in IPSAS 9 are met.

IPSAS 10, Financial Reporting in Hyperinflationary Economies

IG46. A first-time adopter complies with IPSAS 4, *The Effects of Changes in Foreign Exchange Rates* in determining its functional currency and presentation currency. When the first-time adopter prepares its opening statement of financial position, it applies IPSAS 10, *Hyperinflationary Economies*, to any periods during which the economy of the functional currency or presentation currency was hyperinflationary.

IG47. If the first-time adopter elects to use the exemptions in paragraphs 64 to 76 of IPSAS 33, it applies IPSAS 10 to periods after the date for which the revalued amount or fair value was determined.

IPSAS 14, Events After the Reporting Date

IG48. Except as described in paragraph IG49, a first-time adopter applies IPSAS 14, *Events After the Reporting Date* in determining whether:

(a) Its opening statement of financial position reflects an event that occurred after the date of transition; and

(b) Comparative amounts in its transitional IPSAS financial statements or its first IPSAS financial statements, where applicable, reflect an event that occurred after the end of that comparative period.

IG49. Paragraphs 23–26 of IPSAS 33 require some modifications to the principles in IPSAS 14 when a first-time adopter determines whether changes in estimates are adjusting or non-adjusting events at the date of adoption of IPSASs (or, when applicable, the end of the comparative period). Cases 1 and 2 below illustrate those modifications. In case 3 below, paragraphs 23–26 of IPSAS 33 do not require modifications to the principles in IPSAS 14.

(a) Case 1—If a first-time adopter's previous basis of accounting required estimates of similar items for the date of adoption of IPSASs, using an accounting policy that is consistent with IPSASs. In this case, the estimates in accordance with IPSASs need to be consistent with estimates made for that date in accordance with previous basis of accounting, unless there is objective evidence that those estimates were in error (see IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*). The first-time adopter reports later revisions to those estimates as events of the period in which it makes the revisions, rather than as adjusting events resulting from the receipt of further evidence about conditions that existed at the date of adoption of IPSASs.

(b) Case 2—Previous basis of accounting required estimates of similar items for the date of adoption of IPSASs, but the first-time adopter made those estimates using accounting policies that are not consistent with its accounting policies in accordance with IPSASs. In this case, the estimates in accordance with IPSASs need to be consistent with the estimates required in accordance with the previous basis of accounting for that date (unless there is objective evidence that those estimates were in error), after adjusting for the difference in accounting policies. The opening statement of financial position reflects those adjustments for the difference in accounting policies. As in case 1, the first-time adopter reports later revisions to those estimates as events of the period in which it makes the revisions.

For example, the previous basis of accounting may have required a first-time adopter to recognize and measure provisions on a basis consistent with IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, except that the previous basis of accounting's measurement was on an undiscounted basis. In this example, the first-time adopter uses the estimates in accordance with its previous basis of accounting as inputs in making the discounted measurement required by IPSAS 19.

(c) Case 3—Previous basis of accounting did not require estimates of similar items for the date of adoption of IPSASs. Estimates in accordance with IPSASs for that date reflect conditions existing at that date. In particular, estimates of market prices, interest rates or foreign exchange rates at the date of adoption of IPSASs reflect market conditions at that date. This is consistent with the distinction in IPSAS 14 between adjusting events after the reporting period and non-adjusting events after the reporting period.

IG50. To illustrate: Entity A's first transitional IPSAS financial statements are for the period ending December 31, 20X5 with the first-time adopter electing to present comparative information. In terms of its previous basis of accounting the following transactions and events are noted in entity A's financial statements for December 31, 20X3 and 20X4:

(a) Estimates of accrued expenses and provisions were made at those dates;

(b) The entity accounted on a cash basis for a defined benefit pension plan; and

(c) No provision was recognized for a court case arising from events that occurred in September 20X4. When the court case was concluded on June 30, 20X5, entity A was required to pay CU1000 and paid this on July 10, 20X5.

In preparing its transitional IPSAS financial statements, entity A concludes that its estimates in accordance with its previous basis of accounting of accrued expenses and provisions at December 31, 20X3 and 20X4 were made on a basis consistent with its accounting policies in accordance with IPSASs. Although some of the accruals and provisions turned out to be overestimates and others to be underestimates, entity A concludes that its estimates were reasonable and that, therefore, no error had occurred. As a result, accounting for those overestimates and underestimates involves the routine adjustment of estimates in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors.*

Application of Requirements

In preparing its opening statement of financial position at January 1, 20X4 and in its comparative statement of financial position at December 31, 20X4, entity A:

(a) Does not adjust the previous estimates for accrued expenses and provisions; and

(b) Makes estimates (in the form of actuarial assumptions) necessary to account for the pension plan in accordance with IPSAS 39, *Employee Benefits*. Entity A's actuarial assumptions at January 1, 20X4 and December 31, 20X4 do not reflect conditions that arose after those dates. For example, entity A's:

(i) Discount rates at January 1, 20X4 and December 31, 20X4 for the pension plan and for provisions reflect market conditions at those dates; and

(ii) Actuarial assumptions at January 1, 20X4 and December 31, 20X4 about future employee turnover rates do not reflect conditions that arose after those dates—such as a significant increase in estimated employee turnover rates as a result of a curtailment of the pension plan in 20X5.

The treatment of the court case at December 31, 20X4 depends on the reason why entity A did not recognize a provision in accordance with its previous basis of accounting at that date.

Assumption 1 – The previous basis of accounting was consistent with IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*. Entity A concluded that the recognition criteria were not met. In this case, entity A's assumptions in accordance with IPSASs are consistent with its assumptions in accordance with its previous basis of accounting. Therefore, entity A does not recognize a provision at December 31, 20X4.

Assumption 2 – Entity A's previous basis of accounting was not consistent with IPSAS 19. Therefore, entity A develops estimates in accordance with IPSAS 19. Under IPSAS 19, an entity determines whether an obligation exists at the end of the reporting period by taking account of all available evidence, including any additional evidence provided by events after the reporting period. Similarly, in accordance with IPSAS 14, *Events after the Reporting Period*, the resolution of a court case after the reporting period is an adjusting event after the reporting period if it confirms that the entity had a present obligation at that date. In this instance, the resolution of the court case confirms that entity A had a liability in September 20X4 (when the events occurred that gave rise to the court case). Therefore, entity A recognizes a provision at December 31, 20X4. Entity A measures that provision by discounting the CU1 000 paid on July 10, 20X5 to its present value, using a discount rate that complies with IPSAS 19 and reflects market conditions at December 31, 20X4.

IG51. Paragraphs 23–26 of the IPSAS 33 do not override requirements in other IPSASs that base classifications or measurements on circumstances existing at a particular date. Examples include:

(a) The identification of a lease (see IPSAS 43, *Leases*); and

(b) The distinction between financial liabilities and equity instruments (see IPSAS 28, *Financial Instruments: Presentation*).

IPSAS 43, *Leases*

IG52. In accordance with paragraph 95 of IPSAS 33 and paragraph 70 of IPSAS 43, a lessor classifies leases as operating leases or finance leases on the basis of circumstances existing at the inception of the lease, on the date of adoption of accrual basis IPSASs. In some cases, the lessee and the lessor may agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification for the lessor in accordance with IPSAS 43 had the changed terms been in effect at the inception of the lease. If so, the revised agreement is considered as a new contract over its term from the date of adoption of accrual basis IPSASs.

IPSAS 17, Property, Plant and Equipment

IG53. If a first-time adopter's depreciation methods and rates in accordance with its previous basis of accounting are acceptable in accordance with IPSASs, it accounts for any change in estimated useful life or depreciation pattern prospectively from when it makes that change in estimate (paragraphs 22 and 26 of IPSAS 33 and paragraph 76 of IPSAS 17). However, in some cases, a first-time adopter's depreciation methods and rates in accordance with its previous basis of accounting may differ from those that would be acceptable in accordance with IPSASs (for example, if they do not reflect a reasonable estimate of the asset's useful life). If those differences have a material effect on the financial statements, the entity adjusts accumulated depreciation in its opening statement of financial position retrospectively so that it complies with IPSASs.

IG54. A first-time adopter may elect to use one of the following amounts as the deemed cost of property, plant and equipment:

(a) Fair value at the date of adoption of IPSASs (paragraph 67 of IPSAS 33), in which case the first-time adopter provides the disclosures required by paragraph 148 of IPSAS 33; or

(b) A revaluation in accordance with its previous basis of accounting that meets the criteria in paragraph 67 of IPSAS 33.

IG55. Subsequent depreciation is based on that deemed cost and starts from the date for which the first-time adopter determined the deemed cost, or where the first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize certain assets, when the exemptions providing the relief have expired, or the asset has been recognized in accordance with IPSAS 17 (whichever is earlier).

IG56. If a first-time adopter chooses as its accounting policy the revaluation model in IPSAS 17 for some or all classes of property, plant and equipment, it presents the cumulative revaluation surplus as a separate component of net assets/equity. The revaluation surplus at the date of adoption of IPSASs is based on a comparison of the carrying amount of the asset at that date with its cost or deemed cost. If the deemed cost is the fair value at the date of adoption of IPSASs or where the first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure certain assets, when the exemptions providing the relief have expired, or the asset has been recognized and/or measured in accordance with IPSAS 17 (whichever is earlier), the first-time adopter provides the disclosures required by paragraph 148 of IPSAS 33.

IG57. If revaluations in accordance with the first-time adopter's previous basis of accounting did not satisfy the criteria in paragraphs 67 or 69 of IPSAS 33, the first-time adopter measures the revalued assets in its opening statement of financial position on one of the following bases:

(a) Cost (or deemed cost) less any accumulated depreciation and any accumulated impairment losses under the cost model in IPSAS 17;

(b) Deemed cost, being the fair value or an alternative when market-based evidence of fair value is not available, at the date of adoption of IPSASs, or where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure certain assets, the date at which the asset is recognized and/or measured during the period of transition, or when the transitional exemptions expire (whichever is earlier); or

(c) A revalued amount, if the entity adopts the revaluation model in IPSAS 17 as its accounting policy in accordance with IPSASs for all items of property, plant and equipment in the same class.

IG58. IPSAS 17 requires each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item to be depreciated separately. However, IPSAS 17 does not prescribe the unit of measurement for recognition of an asset, i.e. what constitutes an item of property, plant and equipment. Thus, judgment is required in applying the recognition criteria to an entity's specific circumstances (paragraphs 18 and 59).

IPSAS 39, Employee Benefits

IG59. At the date of adoption of IPSASs, a first-time adopter applies IPSAS 39 in measuring defined benefits plans and other long-term employee benefits, and recognizes all cumulative actuarial gains or losses from the inception of the plan until the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemption that provides a three year transitional relief period from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the defined benefits plans and other long-term employee benefits are recognized and/or measured in accordance with IPSAS 39 (whichever is earlier).

IG60. A first-time adopter's actuarial assumptions at the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemptions that provide relief from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the defined benefits plans and other long-term employee benefits are recognized and/or measured in accordance with IPSAS 39 (whichever is earlier), are consistent with actuarial assumptions made at the end of its comparative period (if the first-time adopter elects to present comparative information in accordance with paragraph 78 of IPSAS 33) in accordance with its previous basis of accounting (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 23 of the IPSAS 33). Any later revisions to those assumptions are an actuarial gain or loss of the period in which the first-time adopter makes the revisions.

IG61. A first-time adopter may need to make actuarial assumptions at the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemptions that provide relief from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the defined benefits plans and other long-term employee benefits are recognized and/or measured in accordance with IPSAS 39 (whichever is earlier), that were not necessary in accordance with its basis of accounting. Such actuarial assumptions do not reflect conditions that arose after the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemptions that provide relief from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the defined benefits plans and other long-term employee benefits are recognized and/or measured in accordance with IPSAS 39 (whichever is earlier). In particular, discount rates and the fair value of plan assets at the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemptions that provide relief from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the liabilities are recognized and/or measured in accordance with IPSAS 39 (whichever is earlier), reflect market conditions at that date. Similarly, the first-time adopter's actuarial assumptions at the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemptions that provide relief from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the defined benefits plans and other long-term employee benefits are recognized and/or measured in accordance with IPSAS 39 (whichever is earlier), about future employee turnover rates do not reflect a significant increase in estimated employee turnover rates as a result of a curtailment of the pension plan that occurred after the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemptions that provide relief from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the defined benefits plans and other long-term employee benefits are recognized and/or measured in accordance with IPSAS 39 (whichever is earlier) (paragraph 23 of IPSAS 33).

IG62. In many cases, a first-time adopter's transitional IPSAS financial statements or its first IPSAS financial statements will reflect measurements of employee benefit obligations at three dates (where a first-time adopter elects to present comparative information in accordance with paragraph 78 of IPSAS 33): the end of the first reporting period, the date of the comparative statement of financial position (where the first-time adopter elects to present comparative information) and the date of adoption of IPSASs, or where the first-time adopter takes advantages of the exemptions that provide relief from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the defined benefits plans and other long-term employee benefits are recognized and/or measured in accordance with IPSAS 39 (whichever is earlier). IPSAS 39 encourages the first-time adopter to involve a qualified actuary in the measurement of all material post-employment benefit obligations. To minimize costs, a first-time adopter may request a qualified actuary to carry out a detailed actuarial valuation at one or two of these dates and roll the valuation(s) forward or back to the other date(s). Any such roll forward or roll back reflects any material transactions and other material events (including changes in market prices and interest rates) between those dates (paragraph 61 of IPSAS 39).

IPSAS 21, Impairment of Non-Cash-Generating Assets and IPSAS 26, Impairment of Cash-Generating Assets

IG63. Paragraph 98 and 108 of IPSAS 33 requires a first-time adopter to apply the requirements in IPSAS 21 and IPSAS 26 prospectively from the date of adoption of accrual basis IPSASs, or where a first-time adopter takes advantage of the exemptions that provide a three year transitional relief period to not recognize and/or measure an asset, the date when the exemptions that provided the relief expire and/or the asset is recognized and/or measured. For example, if an entity adopts accrual basis IPSASs on January 1, 20X1 and takes advantage of the three year transitional relief period to not recognize and/or measure an item or property, plant and equipment, if would not be required to assess the item of property, plant and equipment for impairment until (a) December 31, 20X3 (i.e. the date on which the transitional exemption expire) or (b) the date following the recognition of the item of property, plant and equipment if it was recognized and/or measured during the period of transition (whichever is earlier).

IG64. The estimates used to determine whether a first-time adopter recognizes an impairment loss (and to measure any such impairment loss) at the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition of assets, the date on which the exemptions expire or when the assets are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier) are consistent with estimates made for at the end of its comparative period (if the first-time adopter elects to present comparative information in accordance with paragraph 78 of IPSAS 33) the first-time adopter's previous basis of accounting (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error (paragraphs 23 and 24 of IPSAS 33). The first-time adopter reports any later revisions to those estimates as an event of the period in which it makes the revisions.

IG65. In assessing whether it needs to recognize an impairment loss (and in measuring any such impairment loss) at the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition of assets, the date on which the exemptions expire or when the assets are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier), the first-time adopter may need to make estimates for that date that were not necessary in accordance with its previous basis of accounting. Such estimates and assumptions do not reflect conditions that arose after the date of transition, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition of assets, the date on which the exemptions expire or when the assets are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier) (paragraph 25 of IPSAS 33).

IPSAS 28, Financial Instruments: Presentation

IG66. In its opening statement of financial position, a first-time adopter applies the criteria in IPSAS 28 to classify financial instruments issued (or components of compound instruments issued) as either financial liabilities or net asset/equity instruments in accordance with the substance of the contractual arrangement when the instrument first satisfied the recognition criteria in IPSAS 28 (paragraphs 13 and 35), without considering events after that date (other than changes to the terms of the instruments).

IPSAS 41, Financial Instruments

Recognition

IG67. A first-time adopter recognizes all financial assets and financial liabilities (including all derivatives) that qualify for recognition in accordance with IPSAS 41 and have not yet qualified for derecognition in accordance with IPSAS 41, except non-derivative financial assets and non-derivative financial liabilities derecognized in accordance with its previous basis of accounting before the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier), to which the first-time adopter does not choose to apply paragraph 116 of IPSAS 33 (see paragraphs 115 and 116 of IPSAS 33).

IG68. For example, a first-time adopter that does not apply paragraph 116 of IPSAS 33 does not recognize assets transferred in a securitization, transfer or other derecognition transaction that occurred before the date of adoption of IPSASs if those transactions qualified for derecognition in accordance with its previous basis of accounting. However, if the first-time adopter uses the same securitization arrangement or other derecognition arrangement for further transfers after the date of transition to IPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier), those further transfers qualify for derecognition only if they meet the derecognition criteria of IPSAS 41.

Embedded Derivatives

IG69. When IPSAS 41 requires a first-time adopter to separate an embedded derivative from a host contract, the initial carrying amounts of the components at the date when the instrument first satisfies the recognition criteria in IPSAS 41 reflect circumstances at that date (IPSAS 41 paragraph 49). If the first-time adopter cannot determine the initial carrying amounts of the embedded derivative and host contract reliably, it measures the entire combined contract as at fair value through surplus or deficit (IPSAS 41 paragraph 52).

Measurement

IG70. In preparing its opening statement of financial position, a first-time adopter applies the criteria in IPSAS 41 to identify those financial assets and financial liabilities that are measured at fair value and those that are measured at amortized cost.

Adjusting the Carrying Amount of Financial Instruments on the Date of Adoption of Accrual Basis IPSASs or During the Period of Transition

IG71. A first-time adopter shall treat an adjustment to the carrying amount of a financial asset or financial liability as an adjustment to be recognized in the opening balance of accumulated surplus or deficit at the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier), only to the extent that it results from adopting IPSAS 41. Because all derivatives, other than those that are financial guarantee contracts or are designated and effective hedging instruments, are classified as held for trading, the differences between the previous carrying amount (which may have been zero) and the fair value of the derivatives are recognized as an adjustment of the balance of accumulated surplus or deficit at the beginning of the financial year in which IPSAS 41 is initially applied, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier).

Hedge Accounting

IG72. Paragraphs 117 to 119 of IPSAS 33 deal with hedge accounting. The designation and documentation of a hedge relationship must be completed on or before the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier) if the hedge relationship is to qualify for hedge accounting from that date. Hedge accounting can be applied prospectively only from the date that the hedge relationship is fully designated and documented.

IG73. A first-time adopter may, in accordance with its previous basis of accounting, have deferred or not recognized gains and losses on a fair value hedge of a hedged item that is not measured at fair value. For such a fair value hedge, a first-time adopter adjusts the carrying amount of the hedged item at the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier). The adjustment is the lower of:

(a) That portion of the cumulative change in the fair value of the hedged item that reflects the designated hedged risk and was not recognized in accordance with its previous basis of accounting; and

(b) That portion of the cumulative change in the fair value of the hedging instrument that reflects the designated hedged risk and, in accordance with its previous basis of accounting, was either (i) not recognized or (ii) deferred in the statement of financial position as an asset or liability.

IG74. A first-time adopter may, in accordance with its previous basis of accounting, have deferred gains and losses on a cash flow hedge of a forecast transaction. If, at the date of adoption of IPSAS, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier), the hedged forecast transaction is not highly probable, but is expected to occur, the entire deferred gain or loss is recognized in net assets/equity. Any net cumulative gain or loss that has been reclassified to net assets/equity on initial application of IPSAS 41 or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier) remains in net assets/equity until (a) the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, (b) the forecast transaction affects surplus or deficit or (c) subsequently circumstances change and the forecast transaction is no longer expected to occur, in which case any related net cumulative gain or loss is reclassified from net assets/equity to surplus or deficit. If the hedging instrument is still held, but the hedge does not qualify as a cash flow hedge in accordance with IPSAS 41, hedge accounting is no longer appropriate starting from the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier).

IPSAS 31, Intangible Assets

IG75. A first-time adopter's opening statement of financial position excludes all intangible assets and other intangible items that do not meet the criteria for recognition in accordance with IPSAS 31 at the date of adoption of IPSAS, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition of intangible assets, the date on which the exemptions expire and/or when the intangible assets are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier) and includes all intangible assets that meet the recognition criteria in IPSAS 31 at that date.

IG76. The criteria in IPSAS 31 require an entity to recognize an intangible asset if, and only if:

(a) It is probable that the future economic benefits that are attributable to the asset will flow to the entity; and

(b) The cost of the asset can be measured reliably.

IPSAS 31 supplements these two criteria with further, more specific, criteria for internally generated intangible assets.

IG77. In accordance with paragraphs 63 and 66 of IPSAS 31, an entity capitalises the costs of internally generated intangible assets prospectively from the date when the recognition criteria are met. IPSAS 33 allows an entity to recognize previously expensed intangible assets to the extent that the item meets the definition of an intangible asset, and the recognition criteria in IPSAS 31. Thus, if an internally generated intangible asset qualifies for recognition at the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition of intangible assets, the date on which the exemptions expire and/or when the intangible assets are recognized and/or measured in accordance with the IPSAS 31 (whichever is earlier) the first-time adopter recognizes and/or measures the asset in its opening statement of financial position even if it had recognized the related expenditure as an expense in accordance with its pervious basis of accounting.

IG78. If the asset does not qualify for recognition in accordance with IPSAS 31 until a later date, its cost is the sum of the expenditure incurred from that later date.

IG79. The criteria in paragraph IG76 also apply to intangible assets acquired separately. In many cases, contemporaneous documentation prepared to support the decision to acquire the asset will contain an assessment of the future economic benefits or service potential. Furthermore, as explained in paragraph 33 of IPSAS 31, the cost of a separately acquired intangible asset can usually be measured reliably.

IG80. A first-time adopter may elect to use one of the following amounts as the deemed cost of intangible assets (except for internally generated intangible assets):

(a) Fair value at the date of adoption of IPSASs, or where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure certain assets, the date at which the asset is recognized and/or measured during the period of transition, or the date on which the exemptions expire (whichever is earlier) (paragraph 67 of IPSAS 33), in which case the entity gives the disclosures required by paragraph 148 of IPSAS 33; or

(b) A revaluation in accordance with its previous basis of accounting that meets the criteria in paragraph 67 of IPSAS 33.

IG81. If a first-time adopter's amortization methods and rates in accordance with its previous basis of accounting are acceptable in accordance with IPSASs, it accounts for any change in estimated useful life or amortization pattern prospectively from when it makes that change in estimate (paragraphs 23 and 24 of IPSAS 33 and paragraph 103 of IPSAS 31). However, in some cases, the first-time adopter's amortization methods and rates in accordance with its previous basis of accounting may differ from those that would be acceptable in accordance with IPSASs (for example, if they do not reflect a reasonable estimate of the asset's useful life). If those differences have a material effect on the financial statements, the first-time adopter adjusts accumulated amortization on in its opening statement of financial position retrospectively so that it complies with IPSASs.

IPSAS 35, Consolidated Financial Statements

IG82. If a first-time adopter did not consolidate a controlled entity in accordance with its previous basis of accounting, then, in its consolidated financial statements, the first-time adopter measures the controlled entity's assets and liabilities at the same carrying amounts as in the accrual basis financial statements of the controlled entity following its adoption of IPSASs, after adjusting for consolidation procedures and for the effects of the public sector combination in which it acquired the controlled entity (paragraph 130 of IPSAS 33). If the controlled entity has not adopted accrual basis IPSASs in its financial statements, the carrying amounts described in the previous sentence are those that IPSASs would require in those financial statements.

Controlling Entity Adopts Accrual Basis IPSASs Before the Controlled Entity

Background

IG83. Controlling entity A presents its (consolidated) first IPSAS financial statements in 20X5. Its controlled entity B, wholly owned by controlling entity A since formation, prepares information in accordance with accrual basis IPSASs for internal consolidation purposes from that date, but controlled entity B does not present its first IPSAS financial statements until 20X7.

Application of Requirements

IG84. If controlled entity B applies paragraph 129(a) of IPSAS 33, the carrying amounts of its assets and liabilities are the same in both its opening IPSAS statement of financial position at January 1, 20X6 and controlling entity's A consolidated statement of financial position (except for adjustments for consolidation procedures) and are based on controlled entity B's date of adoption of IPSASs.

IG85. Alternatively, controlled entity B, in accordance with paragraph 129(b) of IPSAS 33, measure all its assets or liabilities based on its own date of adoption of IPSASs (January 20X6). However, the fact that controlled entity B becomes a first-time adopter in 20X7 does not change the carrying amounts of its assets and liabilities in controlling entity A's consolidated financial statements.

Controlled Entity Adopts Accrual Basis IPSASs Before the Controlling Entity

Background

IG86. Controlling entity C presents its (consolidated) transitional IPSAS financial statements IPSASs in 20X7. Its controlled entity D, wholly owned by controlling entity C since formation, presented its transitional IPSAS financial statements in 20X5. Until 20X7, controlled entity D prepared information for internal consolidation purposes in accordance with controlling entity's C previous basis of accounting.

Application of Requirements

IG87. The carrying amounts of controlled entity D's assets and liabilities at January 1, 20X6 are the same in both controlling entity's C (consolidated) opening accrual basis statement of financial position and controlled entity D's financial statements (except for adjustments for consolidation procedures) and are based on controlled entity D's date of adoption of IPSASs. The fact that controlling entity C becomes a first-time adopter in 20X7 does not change those carrying amounts (paragraph 129 of IPSAS 33).

IG88. Paragraphs 129 and 130 of IPSAS 33 do not override the following requirements:

(a) The rest of IPSAS 33 in measuring all assets and liabilities for which paragraphs 129 and 130 of IPSAS 33 are not relevant.

(b) To give all disclosures required by this IPSAS as of the first-time adopter's own date of transition to IPSASs.

IG89. Paragraph 129 of IPSAS 33 applies if a controlled entity becomes a first-time adopter later than its controlling entity, for example if the controlling entity previously prepared a reporting package in accordance with accrual basis IPSASs for consolidation purposes but did not present a full set of financial statements in accordance with IPSASs. This may be relevant not only when a controlling entity reporting package complies fully with the recognition and measurement requirements of IPSASs, but also when it is adjusted centrally for matters such as review of events after the reporting date and central allocation of pension costs. However, paragraph 129 of IPSAS 33 does not permit a controlled entity to ignore misstatements that are immaterial to the consolidated financial statements of its controlling entity but material to its own financial statements.

Presentation and Disclosure

IG90. Paragraphs 135 to 140 in IPSAS 33 require a first-time adopter to disclose certain information when it has taken advantage of the transitional exemptions and provisions in its adoption of accrual basis IPSASs.

To illustrate:

Notes to the financial statements for the year ending December 31, 20X2

Note 48 – Adoption of transitional exemptions and provisions in IPSAS 33

Public Sector Entity X adopted accrual basis IPSAS on January 1, 20X1 and elected to adopt the transitional exemption in IPSAS 33 that allows it to apply a deemed cost and a period of up to three years in which to measure land and buildings and investment property.

Public Sector Entity X took advantage of these exemptions in determining a deemed cost, and to measure its land and buildings and investment property. As a result of adopting these transitional exemptions and provisions the entity is not able to make an explicit and unreserved statement about its compliance with accrual basis IPSASs, as the adoption of these transitional exemptions affect the fair presentation of Public Sector Entity X's financial statements and its ability to assert compliance with accrual basis IPSASs.

No other transitional exemptions that affect fair presentation and compliance with accrual basis IPSASs during the period of transition were adopted or applied to any other assets and/or liabilities.

During the period under review, Public Sector Entity X restated its opening balance of investment property with an additional value of CU 1 200 000 after determining the deemed cost on June 30, 20X2 for the investment property under its control.

As at year end, Public Sector Entity X has not yet determined a deemed cost for land and buildings and has not yet measured these assets in its financial statements. Land and buildings reflect a closing balance of CU 2 500 000 as at December 31, 20X2. This value was determined under Public Sector Entity X's previous basis of accounting.

Public Sector Entity X plans to apply a three year transitional exemption for measuring its land and buildings and in determining a deemed cost for these asset.

Public Sector Entity X has appointed an appraiser to value the land and has developed a model for the measurement of buildings. The progress in determining the valuations for land and buildings is in accordance with its implementation plan.

Summary of Transitional Exemptions and Provisions Included in IPSAS 33 *First-time Adoption of Accrual Basis IPSASs*

IG91. The diagram below summarizes the transitional exemptions and provisions included in other accrual basis IPSASs

IPSAS	Transitional exemption provided							
	NO	YES						
		Deemed cost	**3 year transitional relief for recognition**	**3 year transitional relief for measurement**	**3 year transitional relief for recognition and/or measurement**	**3 year transitional relief for disclosure**	**Elimination of transactions, balances, revenue and expenses**	**Other**
IPSAS 1, *Presentation of Financial Statements*						√ To extent that 3 year relief period was adopted		• Presenting comparative info encouraged
IPSAS 2, *Cash Flow Statements*	√							
IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*	√							
IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*								• Exemption to comply with requirements for cumulative translation • Not required to apply Appendix A to items initially recognized before the date of adoption of IPSASs
IPSAS 5, *Borrowing Costs*			√ When allowed alternative is elected as accounting policy					• Encouraged to apply benchmark treatment retrospectively • Allowed alternative must be applied retrospectively
IPSAS 9, *Revenue from Exchange Transactions*	√				√ To extent that 3 year relief period was adopted for assets and/or liabilities			
IPSAS 10, *Financial Reporting In Hyperinflationary Economies*								• Provisions around severe hyperinflation
IPSAS 11, *Construction Contracts*	√							
IPSAS 12, *Inventories*		√	√ Inventory not recognized under previous basis of accounting	√ Inventory recognized under previous basis of accounting				
IPSAS 14, *Events After the Reporting Date*	√							

IPSAS	Transitional exemption provided							
	NO	YES						
		Deemed cost	**3 year transitional relief for recognition**	**3 year transitional relief for measurement**	**3 year transitional relief for recognition and/or measurement**	**3 year transitional relief for disclosure**	**Elimination of transactions, balances, revenue and expenses**	**Other**
IPSAS, 16 *Investment Property*		√	√ Investment property not recognized under previous basis of accounting	√ Investment property recognized under previous basis of accounting				
IPSAS 17, *Property, Plant and Equipment*		√	√ Property, plant and equipment not recognized under previous basis of accounting	√ Property, plant and equipment recognized under previous basis of accounting				
IPSAS 18, *Segment Reporting*	√ No segment report to the extent that 3 year relief period was adopted							
IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*			√ Only liabilities related to assets not recognized under previous basis of accounting to be included initial estimate of cost of dismantling/ removing item/ restoring site	√ Only liabilities related to assets recognized under previous basis of accounting to be included initial estimate of cost of dismantling/ removing item/ restoring site				
IPSAS 20, *Related Party Disclosures*						√		
IPSAS 21, *Impairment of Non-Cash-Generating Assets*								• Prospective application

IPSAS	**Transitional exemption provided**							
	NO	**YES**						
		Deemed cost	**3 year transitional relief for recognition**	**3 year transitional relief for measurement**	**3 year transitional relief for recognition and/or measurement**	**3 year transitional relief for disclosure**	**Elimination of transactions, balances, revenue and expenses**	**Other**
IPSAS 22, *Disclosure of Information About the General Government Sector*	√							
IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*			√ All non-exchange revenue not recognized under previous basis of accounting	√ All non-exchange revenue recognized under previous basis of accounting	√ To extent that 3 year relief period was adopted for assets and/or liabilities			
IPSAS 24, *Presentation of Budget Information in Financial Statements*	√							
IPSAS 26, *Impairment of Cash-Generating Assets*			√					• Prospective application
IPSAS 27, *Agriculture*			√ Biological and agricultural activities not recognized under previous basis of accounting	√ Biological and agricultural activities recognized under previous basis of accounting				
IPSAS 28, *Financial Instruments: Presentation*								• Provisions not to separate liability and net asset/equity component under specific circumstances
IPSAS 30, *Financial Instruments: Disclosures*								• No comparative info about nature and extent of risks
IPSAS 31, *Intangible Assets*		√ Intangible assets other than internally generated I/A	√ Intangible assets not recognized under previous basis of accounting	√ Intangible assets recognized under previous basis of accounting				• Provision to recognise previously expensed internally generated intangible assets

IPSAS	Transitional exemption provided							
	NO	YES						
		Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other
IPSAS 32, *Service Concession Arrangements: Grantor*		√ Service concession asset	√ Service concession asset and related liability not recognized under previous basis of accounting	√ Service concession asset and related liability recognized under previous basis of accounting				• Provision on how to recognize related liability
IPSAS 35, *Consolidated Financial Statements*		√			√ To appropriately classify and identify interests in other entities		√	• Provisions when controlling and/or controlled entity adopts IPSAS at different time • Exemption to not prepare financial statements as consolidated financial statements • *(Assess if investment entity on date of adoption and measure at fair value at that date)*
IPSAS 36, *Investments in Associates and Joint Ventures*		√			√ To appropriately classify and identify interests in other entities		√	• Provisions when controlling entity and associate adopts IPSAS at different time • Exemption to not include investment in associate in consolidated financial statements
		√			√ To appropriately classify and identify interests in other entities		√	• Provisions when controlling entity and associate and jointly controlled entities adopt IPSAS at different time • Exemption to not include interests in joint venture in consolidated financial statements
IPSAS 37, *Joint Arrangements*								• Provision on how to measure investment in joint venture previously accounted for using proportionate consolidation
IPSAS 39, *Employee Benefits*			√ defined benefit plans and other long-term employee benefits not recognized under previous basis of accounting	√ for defined benefit and other long-term employee benefits recognized under previous basis of accounting				• Provisions on how to determine initial liability • Provision to not separate cumulative actuarial gains and losses

IPSAS	**Transitional exemption provided**							
	NO	**YES**						
		Deemed cost	**3 year transitional relief for recognition**	**3 year transitional relief for measurement**	**3 year transitional relief for recognition and/or measurement**	**3 year transitional relief for disclosure**	**Elimination of transactions, balances, revenue and expenses**	**Other**
IPSAS 41, *Financial Instruments*		√	√ For financial instruments not recognized under previous basis of accounting	√ For financial instruments recognized under previous basis of accounting				• Provisions around designation/ derecognition/ hedge accounting • Apply impairment principles prospectively
IPSAS 42, *Social Benefits*			√ liabilities for social benefits not recognized under previous basis of accounting	√ liabilities for social benefits recognized under previous basis of accounting				
IPSAS 43, *Leases*			√ Leased assets and/ or liabilities not recognized under previous basis of accounting	√ Leased assets and/ or liabilities recog- nized under previous basis of				

Appendix

Differentiation between transitional exemptions and provisions that a first-time adopter is required to apply and/or can elect to apply on adoption of accrual basis IPSASs

This Appendix summarises how the transitional exemptions and provisions that a first-time adopter is required to apply in terms of this IPSAS, and those that a first-time adopter may elect to apply on adoption of accrual basis IPSASs.

As the transitional exemptions and provisions that may be elected can also affect the fair presentation and the first-time adopter's ability to assert compliance with accrual basis IPSASs as explained in paragraphs 27 to 32 of IPSAS 33, the Appendix makes a distinction between those transitional exemptions and provisions that affect fair presentation and the ability to assert compliance with accrual basis IPSASs, and those that do not.

Transitional exemption or provision	**Transitional exemptions or provisions that have to be applied**	**Transitional exemptions or provisions that may be applied or elected**	
	Do not affect fair presentation and compliance with accrual basis IPSAS	Do not affect fair presentation and compliance with accrual basis IPSAS	Affect fair presentation and compliance with accrual basis IPSAS
IPSAS 1 • Present comparative information		√	
IPSAS 4 • Cumulative transitional differences at the date of adoption • Not required to apply Appendix A to items initially recognized before the date of adoption of IPSASs		√ √	
IPSAS 5 • Allowed alternative treatment and has taken advantage of relief period • Adopt allowed alternative treatment on date of adoption – retrospective application • Adopt bench mark treatment on the date of adoption – retrospective application of costs incurred before and after date of adoption	√	√	√
IPSAS 9 • Relief for recognition and/or measurement of revenue related to adoption of three year relief period for recognition and/or measurement of financial instruments			√
IPSAS 10 • Determine if hyperinflationary economy is subject to severe hyperinflation at the date of adoption • Measure assets and liabilities if date of adoption is on or after normalisation date	√ √		
IPSAS 12 • Three year relief for recognition and/or measurement of assets and changing the accounting policy to measure assets			√

Transitional exemption or provision	Transitional exemptions or provisions that have to be applied	Transitional exemptions or provisions that may be applied or elected	
	Do not affect fair presentation and compliance with accrual basis IPSAS	Do not affect fair presentation and compliance with accrual basis IPSAS	Affect fair presentation and compliance with accrual basis IPSAS
IPSAS 16 • Three year relief for recognition and/or measurement of assets and changing the accounting policy to measure assets			√
IPSAS 17 • Three year relief for recognition and/or measurement of assets and changing the accounting policy to measure assets			√
IPSAS 18 • No preparation of segment report within three years of adoption		√	
IPSAS 19 • No recognition and measurement of liability relating to initial estimate of costs of dismantling and removing item if relief for recognition and/or measurement of assets are adopted			√
IPSAS 20 • No disclosure of related party relationships, related party transactions and information about key management personnel			√
IPSAS 21 • Apply impairment provisions prospectively on date of adoption or when assets are recognised when relief period was applied	√		
IPSAS 26 • Apply impairment provisions prospectively on date of adoption or when assets are recognised when relief period was applied	√		
IPSAS 27 • Three year relief for recognition and/or measurement of assets and changing the accounting policy to measure assets			√
IPSAS 28 • Determine if financial instrument has liability and net asset/equity component on date of adoption • Do not separate compound financial instrument if no liability exists on date of adoption	√ √		

Transitional exemption or provision	**Transitional exemptions or provisions that have to be applied**	**Transitional exemptions or provisions that may be applied or elected**	
	Do not affect fair presentation and compliance with accrual basis IPSAS	Do not affect fair presentation and compliance with accrual basis IPSAS	Affect fair presentation and compliance with accrual basis IPSAS
IPSAS 30 • No disclosure of information about nature and extent of risks		√	
IPSAS 31 • Three year relief for recognition and/or measurement of assets and changing the accounting policy to measure assets • Recognize all internally generated intangible assets	√		√
IPSAS 32 • Three year relief for recognition and/or measurement of assets and/or liabilities and changing the accounting policy to measure assets and/or liabilities • Measure liability either under financial liability model or grant of a right to the operator model on date of adoption or when asset is recognised if relief period is adopted	√		√
Applying deemed cost to assets and/or liabilities		√	
Applying deemed cost to assets acquired in a non-exchange transaction		√	
Using deemed cost for investments in controlled entities, jointly controlled entities and associates		√	
Preparing reconciliations during transitional period	√		
IPSAS 35 • Relief to recognize and/or measure interests in controlled entity • Elect to not eliminate inter-entity balances, transactions, revenue and expenses • Controlled entity becomes first-time adopter later or earlier than its controlling entity	√		√ √

Transitional exemption or provision	**Transitional exemptions or provisions that have to be applied**	**Transitional exemptions or provisions that may be applied or elected**	
	Do not affect fair presentation and compliance with accrual basis IPSAS	Do not affect fair presentation and compliance with accrual basis IPSAS	Affect fair presentation and compliance with accrual basis IPSAS
• Not present financial statements as consolidated financial statements if three year relief for recognition and/or measurement and/or elimination option was adopted • *Assess if investment entity on date of adoption and determine fair value at that date*	 √		√
IPSAS 36 • Relief to recognize and/or measure interest in associate • Elect to not eliminate share in associate's surplus and deficit • Associate becomes first-time adopter later or earlier than its controlling entity • Not present investment in associates in consolidated financial statements if three year relief for recognition and/or measurement and/or elimination option was adopted	 √		√ √ √
IPSAS 37 • *Measure investment in joint venture previously accounted for using proportionate consolidation*	√		
IPSAS 39 • Three year relief for recognition and/or measurement of assets and/or liabilities and changing the accounting policy to measure assets and/or liabilities • Determine initial liability for defined benefit and other long-term employee benefit plans on date of adoption or when relief period expired • Recognize increase/decrease on date of adoption or when relief period expires in opening accumulated surplus/deficit	√ √		√

Transitional exemption or provision	**Transitional exemptions or provisions that have to be applied**	**Transitional exemptions or provisions that may be applied or elected**	
	Do not affect fair presentation and compliance with accrual basis IPSAS	Do not affect fair presentation and compliance with accrual basis IPSAS	Affect fair presentation and compliance with accrual basis IPSAS
IPSAS 41			
• Three-year relief for recognition and/or measurement of assets and/or liabilities and changing the accounting policy to measure assets and/or liabilities			√
Designation			
• Designate financial asset or liability at fair value through surplus or deficit on date of adoption	√		
Impairment			
• Apply impairment provisions prospectively on date of adoption	√		
Derecognition			
• Apply derecognition provisions prospectively on date of adoption	√		
• Apply derecognition provisions retrospectively if information is available as at the date of initial accounting		√	
Hedge accounting			
• Measure derivatives at fair value	√		
• Eliminate all deferred losses and gains	√		
• Only reflect hedges that qualify for hedge accounting on date of adoption	√		
• Discontinue hedge transaction if conditions of hedge accounting on date of adoption are not met	√		
IPSAS 43			
• Where a first-time adopter is a lessee no recognition and/or measurement of lease liability and right-of-use asset if relief period for recognition and/or measurement of assets is adopted			√
• Identification of a lease based on circumstances at adoption of accrual basis IPSAS	√		

IPSAS 34—SEPARATE FINANCIAL STATEMENTS

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 27, *Separate Financial Statements* published by the International Accounting Standards Board (IASB). Extracts from IAS 27 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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IPSAS 34—SEPARATE FINANCIAL STATEMENTS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 34, *Separate Financial Statements* was issued in January 2015.

Since then, IPSAS 34 has been amended by the following IPSASs:

- *COVID-19: Deferral of Effective Dates* (issued November 2020)
- *Improvements to IPSAS 2018* (issued October 2018)
- IPSAS 41, *Financial Instruments* (issued August 2018)
- *The Applicability of IPSASs* (issued April 2016)

Table of Amended Paragraphs in IPSAS 34

Paragraph Affected	How Affected	Affected By
4	Deleted	The Applicability of IPSASs April 2016
5	Deleted	The Applicability of IPSASs April 2016
6	Amended	IPSAS 41 August 2018
12	Amended	IPSAS 41 August 2018
13	Amended	IPSAS 41 August 2018
14	Amended	IPSAS 41 August 2018 Improvements to IPSAS October 2018
15	Amended	IPSAS 41 August 2018
22	Amended	IPSAS 41 August 2018 Improvements to IPSAS October 2018
26	Amended	IPSAS 41 August 2018
30	Amended	IPSAS 41 August 2018 Improvements to IPSAS October 2018
32A	New	The Applicability of IPSASs April 2016
32B	Amended	COVID-19: Deferral of Effective Dates November 2020
32C	New	Improvements to IPSAS October 2018

IPSAS 34—SEPARATE FINANCIAL STATEMENTS

CONTENTS

International Public Sector Accounting Standard 34, *Separate Financial Statements*, is set out in paragraphs 1–34. All the paragraphs have equal authority. IPSAS 34 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities***.** IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors,* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting and disclosure requirements for investments in controlled entities, joint ventures and associates when an entity prepares separate financial statements.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for investments in controlled entities, joint ventures and associates when it elects, or is required by regulations, to present separate financial statements.**

3. This Standard does not mandate which entities produce separate financial statements. It applies when an entity prepares separate financial statements that comply with International Public Sector Accounting Standards (IPSASs).

4. [Deleted]

5. [Deleted]

Definitions

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

   <u>Consolidated financial statements</u> are the financial statements of an economic entity in which the assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity and its controlled entities are presented as those of a single economic entity.

   <u>Separate financial statements</u> are those presented by an entity, in which the entity could elect, subject to the requirements in this Standard, to account for its investments in controlled entities, joint ventures and associates either at cost, in accordance with IPSAS 41, *Financial Instruments* or using the equity method as described in IPSAS 36, *Investments in Associates and Joint Ventures*.

   Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately. The following terms are defined in IPSAS 35, *Consolidated Financial Statements*, IPSAS 36, *Investments in Associates and Joint Ventures* or IPSAS 37, *Joint Arrangements*: associate, control, controlled entity, controlling entity, economic entity, equity method, investment entity, joint control, joint operation, joint venture, joint venturer and significant influence.

7. Separate financial statements are those presented in addition to consolidated financial statements or in addition to the financial statements of an investor that does not have controlled entities but has investments in associates or joint ventures in which the investments in associates or joint ventures are required by IPSAS 36 to be accounted for using the equity method, other than in the circumstances set out in paragraphs 9–10.

8. The financial statements of an entity that does not have a controlled entity, associate or joint venturer's interest in a joint venture are not separate financial statements.

9. An entity that is exempted in accordance with paragraph 5 of IPSAS 35, from consolidation or paragraph 23 of IPSAS 36, from applying the equity method may present separate financial statements as its only financial statements.

10. An investment entity that is required, throughout the current period and all comparative periods presented, to measure its investment in all its controlled entities at fair value through surplus or deficit in accordance with paragraph 56 of IPSAS 35, presents separate financial statements as its only financial statements.

Preparation of Separate Financial Statements

11. **Separate financial statements shall be prepared in accordance with all applicable IPSASs, except as provided in paragraph 12.**

12. **When an entity prepares separate financial statements, it shall account for similar investments in controlled entities, joint ventures and associates either:**

    (a) **At cost;**

    (b) **In accordance with IPSAS 41; or**

    (c) **Using the equity method as described in IPSAS 36.**

13. **If an entity elects, in accordance with paragraph 24 of IPSAS 36, to measure its investments in associates or joint ventures at fair value through surplus or deficit in accordance with IPSAS 41, it shall also account for those investments in the same way in its separate financial statements.**

14. **If a controlling entity is required, in accordance with paragraph 56 of IPSAS 35, to measure its investment in a controlled entity at fair value through surplus or deficit in accordance with IPSAS 29 (or IPSAS 41 when an entity applies that Standard), it shall also account for that investment in the same way in its separate financial statements. A controlling entity that is not itself an investment entity, shall measure its investments in a controlled investment entity in accordance with paragraph 12 in its separate financial statements.**

15. **When a controlling entity ceases to be an investment entity, or becomes an investment entity, it shall account for the change from the date when the change in status occurred, as follows:**

    (a) **When an entity ceases to be an investment entity, the entity shall account for an investment in a controlled entity in accordance with paragraph 12. The date of the change of status shall be the deemed acquisition date. The fair value of the controlled entity at the deemed acquisition date shall represent the transferred deemed consideration when accounting for the investment in accordance with paragraph 12.**

    (b) **When an entity becomes an investment entity, it shall account for an investment in a controlled entity at fair value through surplus or deficit in accordance with IPSAS 41. The difference between the previous carrying amount of the controlled entity and its fair value at the date of the change of status of the investor shall be recognized as a gain or loss in surplus or deficit. The cumulative amount of any gain or loss previously recognized directly in net assets/equity in respect of those controlled entities shall be treated as if the investment entity had disposed of those controlled entities at the date of change in status.**

16. **Dividends or similar distributions from a controlled entity, a joint venture or an associate are recognized in the separate financial statements of an entity when the entity's right to receive the dividend or similar distribution is established. The dividend or similar distribution is recognized in surplus or deficit unless the entity elects to use the equity method, in which case the dividend or similar distribution is recognized as a reduction from the carrying amount of the investment.**

17. **When a controlling entity reorganizes the structure of its economic entity by establishing a new entity as its controlling entity in a manner that satisfies the following criteria:**

    (a) **The new controlling entity obtains control of the original controlling entity either (i) by issuing equity instruments in exchange for existing equity instruments of the original controlling entity or (ii) by some other mechanism which results in the new controlling entity having a controlling ownership interest in the original controlling entity;**

    (b) **The assets and liabilities of the new economic entity and the original economic entity are the same immediately before and after the reorganization; and**

    (c) **The owners of the original controlling entity before the reorganization have the same absolute and relative interests in the net assets of the original economic entity and the new economic entity immediately before and after the reorganization;**

    and the new controlling entity accounts for its investment in the original controlling entity in accordance with paragraph 12(a) in its separate financial statements, the new controlling entity shall measure cost at the carrying amount of its share of the net assets/equity items shown in the separate financial statements of the original controlling entity at the date of the reorganization.

18. Similarly, an entity that is not a controlling entity might establish a new entity as its controlling entity in a manner that satisfies the criteria in paragraph 17. The requirements in paragraph 17 apply equally to such reorganizations. In such cases, references to "original controlling entity" and "original economic entity" are to the "original entity".

Disclosure

19. **An entity shall apply all applicable IPSASs when providing disclosures in its separate financial statements, including the requirements in paragraphs 20–23.**

20. **When a controlling entity, in accordance with paragraph 5 of IPSAS 35, elects not to prepare consolidated financial statements and instead prepares separate financial statements, it shall disclose in those separate financial statements:**

(a) **The fact that the financial statements are separate financial statements; that the exemption from consolidation has been used; the name of the entity whose consolidated financial statements that comply with IPSASs have been produced for public use; and the address where those consolidated financial statements are obtainable.**

(b) **A list of significant investments in controlled entities, joint ventures and associates, including:**

(i) **The name of those controlled entities, joint ventures and associates.**

(ii) **The jurisdiction in which those controlled entities, joint ventures and associates operate (if it is different from that of the controlling entity).**

(iii) **Its proportion of the ownership interest held in those entities and a description of how that ownership interest has been determined.**

(c) **A description of the method used to account for the controlled entities, joint ventures and associates listed under (b).**

21. **When an investment entity that is a controlling entity (other than a controlling entity covered by paragraph 20) prepares, in accordance with paragraph 10, separate financial statements as its only financial statements, it shall disclose that fact. The investment entity shall also present the disclosures relating to investment entities required by IPSAS 38, *Disclosure of Interests in Other Entities*.**

22. **If a controlling entity that is not itself an investment entity is required to apply the requirements of paragraph 58 of IPSAS 35, it shall disclose its accounting policy choice for measuring its investment in the investment entity in its separate financial statements, and present the disclosures relating to investment entities required by IPSAS 38.**

23. **When a controlling entity (other than a controlling entity covered by paragraphs 20–21) or an investor with joint control of, or significant influence over, an investee prepares separate financial statements, the controlling entity or investor shall identify the financial statements prepared in accordance with IPSAS 35, IPSAS 36 or IPSAS 37, to which they relate. The controlling entity or investor shall also disclose in its separate financial statements:**

(a) **The fact that the statements are separate financial statements and the reasons why those statements are prepared, if not required by legislation or other authority.**

(b) **A list of significant controlled entities, joint ventures and associates, including:**

(i) **The name of those controlled entities, joint ventures and associates.**

(ii) **The jurisdiction in which those controlled entities, joint ventures and associates operate (if different from that of the controlling entity).**

(iii) **Its proportion of the ownership interest held in those entities and a description of how that ownership interest has been determined.**

(c) **A description of the method used to account for the controlled entities, joint ventures and associates listed under (b).**

Transitional Provisions

24. **At the date of initial application, an investment entity that previously measured its investment in a controlled entity at cost shall instead measure that investment at fair value through surplus or deficit as if the requirements of this Standard had always been effective. The investment entity shall adjust retrospectively the annual period immediately preceding the date of initial application and shall adjust accumulated surplus/deficit at the beginning of the immediately preceding period for any difference between:**

(a) **The previous carrying amount of the investment; and**

(b) **The fair value of the investor's investment in the controlled entity.**

25. **At the date of initial application, an investment entity that previously measured its investment in a controlled entity at fair value directly to net assets/equity shall continue to measure that investment at fair value. The cumulative amount of any fair value adjustment previously recognized in net assets/equity shall be transferred to accumulated surplus/deficit at the beginning of the annual period immediately preceding the date of initial application.**

26. **At the date of initial application, an investment entity shall not make adjustments to the previous accounting for an interest in a controlled entity that it had previously elected to measure at fair value through surplus or deficit in accordance with IPSAS 41, as permitted in paragraph 12.**

27. **An investment entity shall use the fair value amounts previously reported to investors or to management.**

28. **If measuring the investment in the controlled entity in accordance with paragraphs 24–27 is impracticable (as defined in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors)*, an investment entity shall apply the requirements of this Standard at the beginning of the earliest period for which application of paragraphs 24–27 is practicable, which may be the current period. The investor shall adjust retrospectively the annual period immediately preceding the date of initial application, unless the beginning of the earliest period for which application of this paragraph is practicable is the current period. When the date that it is practicable for the investment entity to measure the fair value of the controlled entity is earlier than the beginning of the immediately preceding period, the investor shall adjust net assets/equity at the beginning of the immediately preceding period for any difference between:**

    (a) **The previous carrying amount of the investment; and**

    (b) **The fair value of the investor's investment in the controlled entity.**

    If the earliest period for which application of this paragraph is practicable is the current period, the adjustment to net assets/equity shall be recognized at the beginning of the current period.

29. **If an investment entity has disposed of, or lost control of, an investment in a controlled entity before the date of initial application of this Standard, the investment entity is not required to make adjustments to the previous accounting for that investment.**

30. **At the date of initial application, a controlling entity that is not itself an investment entity but which is required, in accordance with paragraph 58 of IPSAS 35, to measure its investment in a controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 41, shall use the transitional provisions in paragraphs 24–29 in accounting for its investment in the controlled investment entity in its separate financial statements.**

31. The transitional provisions for changes in the accounting, in an entity's separate financial statements, for its interest in a joint operation are set out in IPSAS 37, *Joint Arrangements*.

Effective Date

32. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2017, it shall disclose that fact and apply IPSAS 35, IPSAS 36, IPSAS 37, and IPSAS 38 at the same time.**

32A. **Paragraphs 4 and 5 were deleted by *The Applicability of IPSASs*, issued in April 2016. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2018, it shall disclose that fact.**

32B. **Paragraphs 6, 12, 13, 14, 15, 22, 26 and 30 were amended by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply IPSAS 41 at the same time.**

32C. **Paragraphs 14, 22 and 30 were amended by *Improvements to IPSAS, 2018*, issued in October 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2019. Earlier application is permitted. If an entity applies these amendments for a period beginning before January 1, 2019, it shall disclose that fact.**

33. When an entity adopts the accrual basis IPSASs as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

Withdrawal and Replacement of IPSAS 6 (December 2006)

34. This Standard is issued concurrently with IPSAS 35. Together, the two Standards supersede IPSAS 6, *Consolidated and Separate Financial Statements* (December 2006). IPSAS 6 remains applicable until IPSAS 34 and IPSAS 35 are applied or become effective, whichever is earlier.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 34.

Objective

BC1. This Basis for Conclusions summarizes the IPSASB's considerations in reaching the conclusions in IPSAS 34. As this Standard is based on IAS 27, *Separate Financial Statements* (Amended in 2011, including amendments up to December 31, 2014), issued by the International Accounting Standards Board (IASB), the Basis for Conclusions outlines only those areas where IPSAS 34 departs from the main requirements of IAS 27 (Amended in 2011), or where the IPSASB considered such departures.

Overview

BC2. In 2012 the IPSASB commenced work on a project to update those IPSASs that dealt with accounting for interests in controlled entities, associates and joint ventures. In October 2013 the IPSASB issued Exposure Drafts (EDs) 48 to 52 which were collectively referred to as *Interests in Other Entities*. ED 48, *Separate Financial Statements,* was based on IAS 27 *Separate Financial Statements* (Amended in 2011), having regard to the relevant public sector modifications in IPSAS 6, *Consolidated and Separate Financial Statements.* In January 2015 the IPSASB issued five new IPSASs, including IPSAS 34. These new IPSASs supersede IPSAS 6, IPSAS 7, *Investments in Associates*, and IPSAS 8, *Interests in Joint Ventures.*

Use of the Equity Method in Separate Statements

BC3. IPSAS 6 permitted an entity, in its separate financial statements, to measure investments in controlled entities, jointly controlled entities and associates:

(a) Using the equity method;

(b) At cost; or

(c) As a financial instrument in accordance with IPSAS 41.

BC4. The IPSASB noted that in 2003 the IASB limited the measurement options for investments presented in an entity's separate financial statements by removing the option to use the equity method. The IPSASB noted that the reasons given by the IASB for making this change included the following:

(a) The focus in separate financial statements is on the performance of the assets as investments. Cost and fair value can provide relevant information for this; and

(b) To the extent that the equity method provides information about the profit and loss of a subsidiary or an associate, that information would be available in the consolidated financial statements.

BC5. The IPSASB also noted that, at the time it issued ED 48, the IASB had signaled its intention to reconsider the use of the equity method in separate financial statements. In deciding to reconsider this issue the IASB acknowledged that corporate law in some countries requires that the equity method of accounting be used to measure certain investments when presenting separate financial statements.

BC6. The IPSASB decided to continue to permit the use of the equity method in separate financial statements for the following reasons:

(a) The equity method is a well-established method of accounting for certain investments in the public sector. In many circumstances where investments are held by public sector entities, the equity method can provide information that is reliable[1] and useful, and possibly at a lower cost than either the cost method or the fair value method. In the public sector, investment entities are often used more as "instruments" to enable service provision, rather than as a holding for investment purposes, as might generally be the case in the private sector. The equity method may therefore, in some circumstances, be better suited to meeting user needs in the public sector, as it allows the financial statements to portray the fluctuations in the equity of, and performance by, an investment over time, in a cost effective and easily understood manner.

1 Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent. Paragraph BC16 of IPSAS 1 discusses the transitional approach to the explanation of reliability.

(b) Although application of the cost method is often relatively straightforward, where investments have been held for some time, using the cost method may result in outdated and less relevant information, in which case, it would not meet user needs.

(c) In the public sector there is likely to be a higher proportion of investments for which there are no active markets and in respect of which fair values are not readily observable. Although the guidance in IPSAS 41 can be used to derive a value for such investments, the IPSASB considered that this approach would generally result in information that did not faithfully represent the underlying circumstances

BC7. A majority of the respondents to ED 48 supported the proposal to permit the use of the equity method in separate financial statements. A further group of respondents also supported this proposal, subject to the IASB reinstating the use of the equity method in separate financial statements. In August 2014 the IASB issued the *Equity Method in Separate Financial Statements (Amendments to IAS 27)*, which reinstated the equity method as an option in separate financial statements. The IPSASB noted the support it had received for this proposal and the reinstatement of the equity method in IAS 27, and agreed to continue to permit the use of the equity method in separate financial statements.

Separate Financial Statements of Investment Entities

BC8. In developing IPSAS 35 the IPSASB decided to introduce the concept of investment entities and to require that a controlling entity that is an investment entity measure its investments in most controlled entities at fair value through surplus or deficit in accordance with IPSAS 41. Consequently, the IPSASB decided to require that an investment entity measure its investments in controlled entities at fair value through surplus or deficit in its separate financial statements. The IPSASB also decided that an investment entity preparing separate financial statements as its only financial statements, should also make the disclosures required in IPSAS 38 about its interests in controlled entities.

BC9. The IPSASB also decided to require a controlling entity of an investment entity that is not itself an investment entity to present consolidated financial statements in which it (i) measures the investments of a controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 41 and (ii) consolidates the other assets and liabilities and revenue and expenses of the controlled investment entity. Consequently, the IPSASB decided to require that a non-investment controlling entity should measure its investment in a controlled investment entity in the same way in its separate financial statements.

Revision of IPSAS 34 as a result of Improvements to IPSAS, 2018

BC9A. Following the issue of IPSAS 34 the IPSASB became aware that the requirements in paragraphs 14 and 30 (which referred to the consolidation of certain balances of a controlled investment entity in separate financial statements) needed to be amended, as a controlling entity does not consolidate items in its separate financial statements. The IPSASB decided to permit a controlling entity that is not itself an investment entity to measure its investments in a controlled investment entity in accordance with paragraph 12 of IPSAS 34 in its separate financial statements. The IPSASB gave effect to this amendment in *Improvements to IPSAS, 2018*.

Revision of IPSAS 34 as a result of the IPSASB's *The Applicability of IPSASs*, issued in April 2016

BC10. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:

(a) Removes the standard paragraphs about the applicability of IPSASs to "public sector entities other than GBEs" from the scope section of each Standard;

(b) Replaces the term "GBE" with the term "commercial public sector entities", where appropriate; and

(c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.

Comparison with IAS 27 (Amended in 2011)

IPSAS 34, *Separate Financial Statements*, is drawn primarily from IAS 27, *Separate Financial Statements* (Amended in 2011, including amendments up to December 31, 2014). At the time of issuing this Standard, the IPSASB has not considered the applicability to public sector entities of IFRS 9, *Financial Instruments.* References to IFRS 9 in the underlying IASB standard have therefore been replaced by references to the IPSASs dealing with financial instruments.

The main differences between IPSAS 34 and IAS 27 (Amended in 2011) are as follows:

- IPSAS 34 uses different terminology, in certain instances, from IAS 27 (Amended in 2011). The most significant examples are the use of the terms "net assets/equity," "economic entity," "controlling entity," "controlled entity", "revenue". The equivalent terms in IAS 27 (Amended in 2011) are "equity," "group," "parent," "subsidiary" and "income."
- IPSAS 34 contains specific requirements for a controlling entity that is not itself an investment entity but which has an investment in a controlled investment entity. IAS 27 (Amended in 2011) does not specify different requirements for such controlling entities because it requires that such investments be consolidated.

IPSAS 35—CONSOLIDATED FINANCIAL STATEMENTS

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Financial Reporting Standard (IFRS) 10, *Consolidated Financial Statements* published by the International Accounting Standards Board (IASB). Extracts from IFRS 10 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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IPSAS 35—CONSOLIDATED FINANCIAL STATEMENTS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 35, *Consolidated Financial Statements* was issued in January 2015.

Since then, IPSAS 35 has been amended by the following IPSASs:

- *COVID-19: Deferral of Effective Dates* (issued November 2020)
- IPSAS 41, *Financial Instruments* (issued August 2018)
- IPSAS 40, *Public Sector Combinations* (issued January 2017)
- IPSAS 39, *Employee Benefits* (issued July 2016)
- *The Applicability of IPSASs* (issued April 2016)

Table of Amended Paragraphs in IPSAS 35

Paragraph Affected	How Affected	Affected By
4	Amended	IPSAS 40 January 2017
6	Amended	IPSAS 39 July 2016
8	Amended	The Applicability of IPSASs April 2016
11	Deleted	The Applicability of IPSASs April 2016
12	Deleted	The Applicability of IPSASs April 2016
13	Deleted	The Applicability of IPSASs April 2016
22	Amended	IPSAS 41 August 2018
40	Amended	IPSAS 40 January 2017
45	Amended	IPSAS 41 August 2018
52	Amended	IPSAS 40 January 2017 IPSAS 41 August 2018
55A	Amended	IPSAS 40 January 2017 IPSAS 41 August 2018
56	Amended	IPSAS 40 January 2017 IPSAS 41 August 2018
57	Amended	IPSAS 40 January 2017
58	Amended	IPSAS 41 August 2018
63	Amended	IPSAS 40 January 2017
79A	New	The Applicability of IPSASs April 2016
79B	New	IPSAS 39 July 2016
79C	New	IPSAS 40 January 2017
79D	New	IPSAS 40 January 2017
79E	Amended	COVID-19: Deferral of Effective Dates November 2020
AG105	Amended	IPSAS 41 August 2018

IPSAS 35—CONSOLIDATED FINANCIAL STATEMENTS

CONTENTS

International Public Sector Accounting Standard 35, *Consolidated Financial Statements*, is set out in paragraphs 1–81. All the paragraphs have equal authority. IPSAS 35 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors,* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

2. To meet the objective in paragraph 1, this Standard:

   (a) Requires an entity (the controlling entity) that controls one or more other entities (controlled entities) to present consolidated financial statements;

   (b) Defines the principle of control, and establishes control as the basis for consolidation;

   (c) Sets out how to apply the principle of control to identify whether an entity controls another entity and therefore must consolidate that entity;

   (d) Sets out the accounting requirements for the preparation of consolidated financial statements; and

   (e) Defines an investment entity and sets out an exception to consolidating particular controlled entities of an investment entity.

Scope

3. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in the preparation and presentation of consolidated financial statements for the economic entity.**

Public Sector Combinations

4. This Standard does not deal with the accounting requirements for public sector combinations and their effect on consolidation, including goodwill arising on a public sector combination (see IPSAS 40, *Public Sector Combinations*).

Presentation of Consolidated Financial Statements

5. **An entity that is a controlling entity shall present consolidated financial statements. This Standard applies to all entities, except that a controlling entity need not present consolidated financial statements if it meets all the following conditions:**

   (a) **It is itself a controlled entity and the information needs of users are met by its controlling entity's consolidated financial statements, and, in the case of a partially owned controlled entity, all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the entity not presenting consolidated financial statements;**

   (b) **Its 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) **It did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market; and**

   (d) **Its ultimate or any intermediate controlling entity produces financial statements that are available for public use and comply with International Public Sector Accounting Standards (IPSASs), in which controlled entities are consolidated or are measured at fair value through surplus or deficit in accordance with this Standard.**

6. This Standard does not apply to post-employment benefit plans or other long-term employee benefit plans to which IPSAS 39, *Employee Benefits* applies.

7. **A controlling entity that is an investment entity shall not present consolidated financial statements if it is required, in accordance with paragraph 56 of this Standard, to measure all of its controlled entities at fair value through surplus or deficit.**

8. A controlled entity is not excluded from consolidation because its activities are dissimilar to those of the other entities within the economic entity, for example, the consolidation of commercial public sector entities with entities in the budget sector. Relevant information is provided by consolidating such controlled entities and disclosing additional information in the consolidated financial statements about the different activities of controlled entities. For example, the disclosures required by IPSAS 18, *Segment Reporting*, help to explain the significance of different activities within the economic entity.

9. The exemption from preparing consolidated financial statements in paragraph 5 does not apply where the information needs of a controlled entity's users would not be met by the consolidated financial statements of its controlling entity. For example, consolidated financial statements at a whole-of-government level may not meet the information needs of users in respect of key sectors or activities of a government. In many jurisdictions there are legislated financial reporting requirements intended to address the information needs of such users.

10. An entity may be required, (for example, by legislation, or by external users) to prepare aggregated financial statements which are for a different economic entity than that required by this Standard. Although such financial statements fall outside the scope of this Standard and would not comply with the requirements in this Standard, an entity could use the guidance in this Standard in the preparation of such aggregated financial statements.

Government Business Enterprises

11. [Deleted]

12. [Deleted]

13. [Deleted]

Definitions

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

<u>Benefits</u> are the advantages an entity obtains from its involvement with other entities. Benefits may be financial or non-financial. The actual impact of an entity's involvement with another entity can have positive or negative aspects.

<u>Binding arrangement</u>: For the purposes of this Standard, a binding arrangement is an arrangement that confers enforceable rights and obligations on the parties to it as if it were in the form of a contract. It includes rights from contracts or other legal rights.

<u>Consolidated financial statements</u> are the financial statements of an economic entity in which the assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity and its controlled entities are presented as those of a single economic entity.

<u>Control</u>: An entity controls another entity when the entity is exposed, or has rights, to variable benefits from its involvement with the other entity and has the ability to affect the nature or amount of those benefits through its power over the other entity.

A <u>controlled entity</u> is an entity that is controlled by another entity.

A <u>controlling entity</u> is an entity that controls one or more entities.

A <u>decision-maker</u> is an entity with decision-making rights that is either a principal or an agent for other parties.

An <u>economic entity</u> is a controlling entity and its controlled entities.

An <u>investment entity</u> is an entity that:

(a) **Obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;**

(b) **Has the purpose of investing funds solely for returns from capital appreciation, investment revenue, or both; and**

(c) **Measures and evaluates the performance of substantially all of its investments on a fair value basis.**

A <u>non-controlling interest</u> is the net assets/equity in a controlled entity not attributable, directly or indirectly, to a controlling entity.

<u>Power</u> consists of existing rights that give the current ability to direct the relevant activities of another entity.

<u>Protective rights</u> are rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.

<u>Relevant activities:</u> For the purpose of this Standard, relevant activities are activities of the potentially controlled entity that significantly affect the nature or amount of the benefits that an entity receives from its involvement with that other entity.

Removal rights are rights to deprive the decision maker of its decision-making authority.

Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately. The following terms are defined in either IPSAS 36, *Investments in Associates and Joint Ventures,* IPSAS 37, *Joint Arrangements,* or IPSAS 38, *Disclosure of Interests in Other Entities*: associate, interest in another entity, joint venture and significant influence.

Binding Arrangement

15. Binding arrangements can be evidenced in several ways. A binding arrangement is often, but not always, in writing, in the form of a contract or documented discussions between the parties. Statutory mechanisms such as legislative or executive authority can also create enforceable arrangements, similar to contractual arrangements, either on their own or in conjunction with contracts between the parties.

Economic Entity

16. The term economic entity is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities. Other terms sometimes used to refer to an economic entity include administrative entity, financial entity, consolidated entity, and group. An economic entity may include entities with both social policy and commercial objectives.

17. The determination of the economic entity will need to be made having regard to the constitutional arrangements in a jurisdiction, in particular the ways in which government power is limited and allocated, and how the government system is set up and operates. For example, in jurisdictions with an executive, legislature and judiciary, these may collectively form an economic entity in respect of which there is a user need for consolidated financial statements. Such consolidated financial statements are commonly referred to as whole-of-government financial statements.

Control (see paragraphs AG2–AG87)

18. **An entity, regardless of the nature of its involvement with another entity, shall determine whether it is a controlling entity by assessing whether it controls the other entity.**

19. **An entity controls another entity when it is exposed, or has rights, to variable benefits from its involvement with the other entity and has the ability to affect the nature or amount of those benefits through its power over the other entity.**

20. **Thus, an entity controls another entity if and only if the entity has all the following:**

    (a) **Power over the other entity (see paragraphs 23–29);**

    (b) **Exposure, or rights, to variable benefits from its involvement with the other entity (see paragraphs 30–34); and**

    (c) **The ability to use its power over the other entity to affect the nature or amount of the benefits from its involvement with the other entity (see paragraphs 35–37).**

21. **An entity shall consider all facts and circumstances when assessing whether it controls another entity. The entity shall reassess whether it controls another entity if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 20 (see paragraphs AG82–AG87).**

22. Two or more entities collectively control another entity when they must act together to direct the relevant activities. In such cases, because no single entity can direct the activities without the co-operation of the others, no single entity controls the other entity. Each entity would account for its interest in the other entity in accordance with the relevant IPSASs, such as IPSAS 36, IPSAS 37,or the IPSASs dealing with financial instruments (IPSAS 28, *Financial Instruments: Presentation*, IPSAS 30, *Financial Instruments: Disclosures*, and IPSAS 41, *Financial Instruments*).

Power

23. An entity has power over another entity when the entity has existing rights that give it the current ability to direct the relevant activities, i.e., the activities that significantly affect the nature or amount of the benefits from its involvement with the other entity. The right to direct the financial and operating policies of another entity indicates that an entity has the ability to direct the relevant activities of another entity and is frequently the way in which power is demonstrated in the public sector.

24. Power arises from rights. In some cases assessing power is straightforward, such as when power over another entity is obtained directly and solely from the voting rights granted by equity instruments such as shares, and can be assessed by considering the voting rights from those shareholdings. However, public sector entities often obtain power over another entity from rights other than voting rights. They may also obtain power over another entity without having an equity instrument providing evidence of a financial investment. An entity may have rights conferred by binding arrangements. These rights may give an entity power to require the other entity to deploy assets or incur liabilities in a way that affects the nature or amount of benefits received by the first-mentioned entity. The assessment of whether such rights give rise to power over another entity may be complex and require more than one factor to be considered.

25. An entity can have power over another entity even if it does not have responsibility for the day-to-day operation of the other entity or the manner in which prescribed functions are performed by that other entity. Legislation may give statutory bodies or statutory officers powers to carry out their functions independently of government. For example, the Auditor-General and Government Statistician usually have statutory powers to obtain information and publish reports without recourse to government and the judiciary often has special powers to give effect to the concept of judicial independence. Legislation may also set out the broad parameters within which the statutory body is required to operate, and result in the statutory body operating in a manner consistent with the objectives set by Parliament or a similar body. The existence of statutory powers to operate independently does not, of itself, preclude an entity having the ability to direct the operating and financial policies of another entity with statutory powers so as to obtain benefits. For example, the independence of a central bank in relation to monetary policy does not preclude the possibility of the central bank being controlled. All facts and circumstances would still need to be considered.

26. The existence of rights over another entity does not necessarily give rise to power for the purposes of this Standard. An entity does not have power over another entity solely due to the existence of:

(a) Regulatory control (see paragraph AG12); or

(b) Economic dependence (see paragraphs AG41–AG42).

27. An entity with the current ability to direct the relevant activities has power even if its rights to direct have yet to be exercised. Evidence that the entity has been directing the relevant activities of the entity being assessed for control can help determine whether the entity has power, but such evidence is not, in itself, conclusive in determining whether the entity has power over the entity being assessed for control. In the case of an entity established with predetermined activities, the right to direct the relevant activities may have been exercised at the time that the entity was established.

28. If two or more entities each have existing rights that give them the unilateral ability to direct different relevant activities, the entity that has the current ability to direct the activities that most significantly affect the nature or amount of benefits from that entity has power over that other entity.

29. An entity can have power over an entity being assessed for control even if other entities have existing rights that give them the current ability to participate in the direction of the relevant activities, for example when another entity has significant influence. However, an entity that holds only protective rights does not have power over another entity (see paragraphs AG29–AG31), and consequently does not control the other entity.

Benefits

30. An entity is exposed, or has rights, to variable benefits from its involvement with an entity being assessed for control when the benefits that it seeks from its involvement have the potential to vary as a result of the other entity's performance. Entities become involved with other entities with the expectation of positive financial or non-financial benefits over time. However, in a particular reporting period, the actual impact of an entity's involvement with the entity being assessed for control can be only positive, only negative or a mix of both positive and negative.

31. The entity's benefits from its involvement with the entity being assessed for control can be only financial, only non-financial or both financial and non-financial. Financial benefits include returns on investment such as dividends or similar distributions and are sometimes referred to as "returns". Non-financial benefits include advantages arising from scarce resources that are not measured in financial terms and economic benefits received directly by service recipients of the entity. Non-financial benefits can occur when the activities of another entity are congruent with, (that is, they are in agreement with), the objectives of the entity and support the entity in achieving its objectives. For example, an entity may obtain benefits when another entity with congruent activities provides services that the first entity would have otherwise been obliged to provide. Congruent activities may be undertaken voluntarily or the entity may have the power to direct the other entity to undertake those activities. Non-financial benefits can also occur when two entities have complementary objectives (that is, the objectives of one entity add to, and make more complete, the objectives of the other entity).

32. The following examples illustrate financial benefits that an entity may receive from its involvement with another entity:

   (a) Dividends, variable interest on debt securities, other distributions of economic benefits;

   (b) Exposure to increases or decreases in the value of an investment in another entity;

   (c) Exposure to loss from agreements to provide financial support, including financial support for major projects;

   (d) Cost savings (for example, if an entity would achieve economies of scale or synergies by combining the operations or assets of the other entity with its own operations or assets);

   (e) Residual interests in the other entity's assets and liabilities on liquidation of that other entity; and

   (f) Other exposures to variable benefits that are not available to other entities.

33. Examples of non-financial benefits include:

   (a) The ability to benefit from the specialized knowledge of another entity;

   (b) The value to the entity of the other entity undertaking activities that assist the entity in achieving its objectives;

   (c) Improved outcomes;

   (d) More efficient delivery of outcomes;

   (e) More efficient or effective production and delivery of goods and services;

   (f) Having an asset and related services available earlier than otherwise would be the case; and

   (g) Having a higher level of service quality than would otherwise be the case.

34. Although only one entity can control another entity, more than one party can share in the benefits of that other entity. For example, holders of non-controlling interests can share in the financial benefits such as surpluses or distributions from an entity or the non-financial benefits such as congruence of activities with desired outcomes.

Link between Power and Benefits

35. An entity controls another entity if the entity not only has power over the entity being assessed for control and exposure or rights to variable benefits from its involvement with the other entity, but also has the ability to use its power to affect the nature or amount of the benefits from its involvement with the entity being assessed for control.

36. The existence of congruent objectives alone is insufficient for an entity to conclude that it controls another entity. In order to have control the entity would also need to have the ability to use its power over the entity being assessed for control to direct that other entity to work with it to further its objectives.

37. **An entity with decision-making rights shall determine whether it is a principal or an agent. An entity shall also determine whether another entity with decision-making rights is acting as an agent for the entity. An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the other entity when it exercises its decision-making authority. Thus, sometimes a principal's power may be held and exercisable by an agent, but on behalf of the principal.**

Accounting Requirements

38. **A controlling entity shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.**

39. **Consolidation of a controlled entity shall begin from the date the entity obtains control of the other entity and cease when the entity loses control of the other entity.**

Consolidation Procedures

40. Consolidated financial statements:

   (a) Combine like items of assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity with those of its controlled entities.

   (b) Offset (eliminate) the carrying amount of the controlling entity's investment in each controlled entity and the controlling entity's portion of net assets/equity of each controlled entity (IPSAS 40 explains how to account for any related goodwill).

(c) Eliminate in full intra-economic entity assets, liabilities, net assets/equity, revenue, expenses and cash flows relating to transactions between entities of the economic entity (surpluses or deficits resulting from intra-economic entity transactions that are recognized in assets, such as inventory and fixed assets, are eliminated in full). Intra-economic entity losses may indicate an impairment that requires recognition in the consolidated financial statements.

Uniform Accounting Policies

41. If a member of the economic entity uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that member's financial statements in preparing the consolidated financial statements to ensure conformity with the economic entity's accounting policies.

Measurement

42. An entity includes the revenue and expenses of a controlled entity in the consolidated financial statements from the date it gains control until the date when the entity ceases to control the controlled entity. Revenue and expenses of the controlled entity are based on the amounts of the assets and liabilities recognized in the consolidated financial statements at the acquisition date. For example, depreciation expense recognized in the consolidated statement of financial performance after the acquisition date is based on the values of the related depreciable assets recognized in the consolidated financial statements at the acquisition date.

Potential Voting Rights

43. When potential voting rights, or other derivatives containing potential voting rights, exist, the proportion of surplus or deficit and changes in net assets/equity allocated to the controlling entity and non-controlling interests in preparing consolidated financial statements is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivatives, unless paragraph 44 applies.

44. In some circumstances an entity has, in substance, an existing ownership interest as a result of a transaction that currently gives the entity access to the benefits associated with an ownership interest. In such circumstances, the proportion allocated to the controlling entity and non-controlling interests in preparing consolidated financial statements is determined by taking into account the eventual exercise of those potential voting rights and other derivatives that currently give the entity access to the benefits.

45. IPSAS 28 and IPSAS 41 do not apply to interests in controlled entities that are consolidated. When instruments containing potential voting rights in substance currently give access to the benefits associated with an ownership interest in a controlled entity, the instruments are not subject to the requirements of IPSAS 28 and IPSAS 41. In all other cases, instruments containing potential voting rights in a controlled entity are accounted for in accordance with IPSAS 28 and IPSAS 41.

Reporting Dates

46. **The financial statements of the controlling entity and its controlled entities used in the preparation of the consolidated financial statements shall be prepared as at the same reporting date. When the end of the reporting period of the controlling entity is different from that of a controlled entity, the controlling entity either:**

(a) **Obtains, for consolidation purposes, additional financial information as of the same date as the financial statements of the controlling entity; or**

(b) **Uses the most recent financial statements of the controlled entity adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements.**

Non-Controlling Interests

47. **A controlling entity shall present non-controlling interests in the consolidated statement of financial position within net assets/equity, separately from the net assets/equity of the owners of the controlling entity.**

48. Changes in a controlling entity's interest in a controlled entity that do not result in the controlling entity losing control of the controlled entity are transactions with owners in their capacity as owners.

49. **An entity shall attribute the surplus or deficit and each gain or loss recognized directly in net assets/equity to the owners of the controlling entity and to the non-controlling interests. The entity shall also attribute the total amount recognized in the statement of changes in net assets/equity to the owners of the controlling entity and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.**

50. **If a controlled entity has outstanding cumulative preference shares that are classified as equity instruments and are held by non-controlling interests, the entity shall compute its share of surplus or deficit after adjusting for the dividends on such shares, whether or not such dividends have been declared.**

Changes in the Proportion held by Non-Controlling Interests

51. **When the proportion of the net assets/equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the controlled entity. The entity shall recognize directly in net assets/equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the controlling entity.**

Loss of Control

52. **If a controlling entity loses control of a controlled entity, the controlling entity:**

  (a) **Derecognizes the assets and liabilities of the former controlled entity from the consolidated statement of financial position;**

  (b) **Recognizes any investment retained in the former controlled entity and subsequently accounts for it and for any amounts owed by or to the former controlled entity in accordance with relevant IPSASs. That retained interest is remeasured, as described in paragraphs 54(b)(iii) and 55A. The remeasured value at the date that control is lost shall be regarded as the fair value on initial recognition of a financial asset in accordance with IPSAS 41 or the cost on initial recognition of an investment in an associate or joint venture, if applicable; and**

  (c) **Recognizes the gain or loss associated with the loss of control attributable to the former controlling interest, as specified in paragraphs 54–55A.**

53. **A controlling entity might lose control of a controlled entity in two or more arrangements (transactions). However, sometimes circumstances indicate that the multiple arrangements should be accounted for as a single transaction. In determining whether to account for the arrangements as a single transaction, a controlling entity shall consider all the terms and conditions of the arrangements and their economic effects. One or more of the following indicate that the controlling entity should account for the multiple arrangements as a single transaction:**

  (a) **They are entered into at the same time or in contemplation of each other.**

  (b) **They form a single transaction designed to achieve an overall commercial effect.**

  (c) **The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.**

  (d) **One arrangement considered on its own is not economically justified, but it is economically justified when considered together with other arrangements. An example is when a disposal of an investment is priced below market and is compensated for by a subsequent disposal priced above market.**

54. **If a controlling entity loses control of a controlled entity, it shall:**

  (a) **Derecognize:**

    (i) **The assets (including any goodwill) and liabilities of the controlled entity at their carrying amounts at the date when control is lost; and**

    (ii) **The carrying amount of any non-controlling interests in the former controlled entity at the date when control is lost (including any gain or loss recognized directly in net assets/equity attributable to them).**

  (b) **Recognize:**

    (i) **The fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control;**

    (ii) **If the transaction, event or circumstances that resulted in the loss of control involves a distribution of shares of the controlled entity to owners in their capacity as owners, that distribution; and**

    (iii) **Any investment retained in the former controlled entity at its fair value at the date when control is lost.**

  (c) **Transfer directly to accumulated surplus/deficit, if required by other IPSASs, the amounts recognized directly in net assets/equity in relation to the controlled entity on the basis described in paragraph 55.**

(d) **Recognize any resulting difference as a gain or loss in surplus or deficit attributable to the controlling entity.**

55. **If a controlling entity loses control of a controlled entity, the controlling entity shall account for all amounts previously recognized directly in net assets/equity in relation to that controlled entity on the same basis as would be required if the controlling entity had directly disposed of the related assets or liabilities. If a revaluation surplus previously recognized directly in net assets/equity would be transferred directly to accumulated surplus/deficit on the disposal of the asset, the controlling entity shall transfer the revaluation surplus directly to accumulated surplus/deficit when it loses control of the controlled entity.**

55A. **If a controlling entity loses control of a controlled entity that does not contain an operation, as defined in IPSAS 40, as a result of a transaction involving an associate or a joint venture that is accounted for using the equity method, the controlling entity determines the gain or loss in accordance with paragraphs 54–55. The gain or loss resulting from the transaction is recognized in the controlling entity's surplus or deficit only to the extent of the unrelated investors' interests in that associate or joint venture. The remaining part of the gain is eliminated against the carrying amount of the investment in that associate or joint venture. In addition, if the controlling entity retains an investment in the former controlled entity and the former controlled entity is now an associate or a joint venture that is accounted for using the equity method, the controlling entity recognizes the part of the gain or loss resulting from the remeasurement at fair value of the investment retained in that former controlled entity in its surplus or deficit only to the extent of the unrelated investors' interests in the new associate or joint venture. The remaining part of that gain is eliminated against the carrying amount of the investment retained in the former controlled entity. If the controlling entity retains an investment in the former controlled entity that is now accounted for in accordance with IPSAS 41, the part of the gain or loss resulting from the remeasurement at fair value of the investment retained in the former controlled entity is recognized in full in the controlling entity's surplus or deficit.**

Investment Entities: Fair Value Requirement

56. **Except as described in paragraph 57, an investment entity shall not consolidate its controlled entities or apply IPSAS 40 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a controlled entity at fair value through surplus or deficit in accordance with IPSAS 41.**

57. **Notwithstanding the requirement in paragraph 56, if an investment entity has a controlled entity that is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity's investment activities (see paragraphs AG98–AG100), it shall consolidate that controlled entity in accordance with paragraphs 38–55 of this Standard and apply the requirements of IPSAS 40 to the acquisition of any such controlled entity.**

58. **A controlling entity of an investment entity that is not itself an investment entity shall present consolidated financial statements in which it (i) measures the investments of a controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 41 and (ii) consolidates the other assets and liabilities and revenue and expenses of the controlled investment entity in accordance with paragraphs 38–55 of this Standard.**

Determining Whether an Entity is an Investment Entity

59. **An entity shall consider all facts and circumstances when assessing whether it is an investment entity, including its purpose and design. Paragraphs AG89–AG106 describe aspects of the definition of an investment entity in more detail. If facts and circumstances indicate that there are changes to one or more of the three elements that make up the definition of an investment entity, a controlling entity shall reassess whether it is an investment entity.**

60. **A controlling entity that either ceases to be an investment entity or becomes an investment entity shall account for the change in its status prospectively from the date at which the change in status occurred (see paragraphs 63–64).**

Judgments and Assumptions

61. **An investment entity shall disclose the information required by paragraph 15 of IPSAS 38 about significant judgments and assumptions made in determining that it is an investment entity unless it has all of the following characteristics:**

(a) **It has obtained funds from more than one investor (see paragraphs AG89–AG90);**

(b) **It has ownership interests in the form of equity or similar interests (see paragraphs AG91–AG92); and**

(c) **It has more than one investment (see paragraphs AG96–AG97).**

62. The absence of any of these characteristics does not necessarily disqualify an entity from being classified as an investment entity. However, the absence of any of these characteristics means that an entity is required to disclose information about the significant judgments and assumptions made in determining that it is an investment entity.

Accounting for a Change in Investment Entity Status

63. **When an entity ceases to be an investment entity, it shall apply IPSAS 40 to any controlled entity that was previously measured at fair value through surplus or deficit in accordance with paragraph 56. The date of the change of status shall be the deemed acquisition date. The fair value of the controlled entity at the deemed acquisition date shall represent the transferred deemed consideration when measuring any goodwill or gain from a bargain purchase that arises from the deemed acquisition. All controlled entities shall be consolidated in accordance with paragraphs 38–51 of this Standard from the date of change of status.**

64. **When an entity becomes an investment entity, it shall cease to consolidate its controlled entities at the date of the change in status, except for any controlled entity that shall continue to be consolidated in accordance with paragraph 57. The investment entity shall apply the requirements of paragraphs 52 and 53 to those controlled entities that it ceases to consolidate as though the investment entity had lost control of those controlled entities at that date.**

Transitional Provisions

65. **An entity shall apply this Standard retrospectively, in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs 66–78.**

66. **Notwithstanding the requirements of paragraph 33 of IPSAS 3, when this Standard is first applied an entity need only present the quantitative information required by paragraph 33(f) of IPSAS 3 for the annual period immediately preceding the date of initial application of this Standard (the "immediately preceding period"). An entity may also present this information for the current period or for earlier comparative periods, but is not required to do so.**

67. For the purposes of this Standard, the date of initial application is the beginning of the annual reporting period for which this Standard is applied for the first time.

68. At the date of initial application, an entity is not required to make adjustments to the previous accounting for its involvement with either:

(a) Entities that would be consolidated at that date in accordance with IPSAS 6, *Consolidated and Separate Financial Statements*, and are still consolidated in accordance with this Standard; or

(b) Entities that would not be consolidated at that date in accordance with IPSAS 6, and are not consolidated in accordance with this Standard.

69. **At the date of initial application, an entity shall assess whether it is an investment entity on the basis of the facts and circumstances that exist at that date. If, at the date of initial application, an entity concludes that it is an investment entity, it shall apply the requirements of paragraphs 70–73 instead of paragraphs 77–78.**

70. **Except for any controlled entity that is consolidated in accordance with paragraph 57 (to which paragraph 68 or paragraphs 77–78, whichever is relevant, apply), an investment entity shall measure its investment in each controlled entity at fair value through surplus or deficit as if the requirements of this Standard had always been effective. The investment entity shall retrospectively adjust both the annual period that immediately precedes the date of initial application and net assets/equity at the beginning of the immediately preceding period for any difference between:**

(a) **The previous carrying amount of the controlled entity; and**

(b) **The fair value of the investment entity's investment in the controlled entity.**

The cumulative amount of any fair value adjustments previously recognized directly in net assets/equity shall be transferred to accumulated surplus/deficit at the beginning of the annual period immediately preceding the date of initial application.

71. **An investment entity shall use the fair value amounts that were previously reported to investors or to management.**

72. **If measuring an investment in a controlled entity in accordance with paragraph 70 is impracticable (as defined in IPSAS 3), an investment entity shall apply the requirements of this Standard at the beginning of the earliest period for which application of paragraph 70 is practicable, which may be the current period. The investor shall retrospectively adjust the annual period that immediately precedes the date of initial application, unless the**

beginning of the earliest period for which application of this paragraph is practicable is the current period. If this is the case, the adjustment to net assets/equity shall be recognized at the beginning of the current period.

73. If an investment entity has disposed of, or has lost control of, an investment in a controlled entity before the date of initial application of this Standard, the investment entity is not required to make adjustments to the previous accounting for that controlled entity.

74. **If, at the date of initial application, an entity concludes that it shall consolidate another entity that was not consolidated in accordance with IPSAS 6, the entity shall measure the assets, liabilities and non-controlling interests in that previously unconsolidated entity as if that other entity had been consolidated from the date when the entity obtained control of that other entity on the basis of the requirements of this Standard. The entity shall adjust retrospectively the annual period immediately preceding the date of initial application. When the date that control was obtained is earlier than the beginning of the immediately preceding period, the entity shall recognize, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:**

    (a) **The amount of assets, liabilities and non-controlling interests recognized; and**

    (b) **The previous carrying amount of the entity's involvement with the other entity.**

75. **If measuring a controlled entity's assets, liabilities and non-controlling interests in accordance with paragraph 74(a) or (b) is impracticable (as defined in IPSAS 3), an entity shall measure the assets, liabilities and non-controlling interests in that previously unconsolidated entity as if that entity had been consolidated from the deemed acquisition date. The deemed acquisition date shall be the beginning of the earliest period for which the application of this paragraph is practicable, which may be the current period.**

76. **The entity shall adjust retrospectively the annual period immediately preceding the date of initial application, unless the beginning of the earliest period for which application of this paragraph is practicable is the current period. When the deemed acquisition date is earlier than the beginning of the immediately preceding period, the entity shall recognize, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:**

    (a) **The amount of assets, liabilities and non-controlling interests recognized; and**

    (b) **The previous carrying amounts of the entity's involvement with the other entity.**

    If the earliest period for which application of this paragraph is practicable is the current period, the adjustment to net assets/equity shall be recognized at the beginning of the current period.

77. **If, at the date of initial application, an entity concludes that it will no longer consolidate an entity that was consolidated in accordance with IPSAS 6, the entity shall measure its interest in the other entity at the amount at which it would have been measured if the requirements of this Standard had been effective when the entity became involved with, or lost control of, the other entity. The entity shall adjust retrospectively the annual period immediately preceding the date of initial application. When the date that the entity became involved with (but did not obtain control in accordance with this Standard), or lost control of, the other entity is earlier than the beginning of the immediately preceding period, the entity shall recognize, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:**

    (a) **The previous carrying amount of the assets, liabilities and non-controlling interests; and**

    (b) **The recognized amount of the entity's interest in the other entity.**

78. **If measuring the interest in the other entity in accordance with paragraph 77 is impracticable (as defined in IPSAS 3), an entity shall apply the requirements of this Standard at the beginning of the earliest period for which application of paragraph 77 is practicable, which may be the current period. The entity shall adjust retrospectively the annual period immediately preceding the date of initial application, unless the beginning of the earliest period for which application of this paragraph is practicable is the current period. When the date that the entity became involved with (but did not obtain control in accordance with this Standard), or lost control of, the other entity is earlier than the beginning of the immediately preceding period, the entity shall recognize, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:**

    (a) **The previous carrying amount of the assets, liabilities and non-controlling interests; and**

    (b) **The recognized amount of the entity's interest in the other entity.**

If the earliest period for which application of this paragraph is practicable is the current period, the adjustment to net assets/equity shall be recognized at the beginning of the current period.

Effective Date

79. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2017, it shall disclose that fact and apply IPSAS 34, *Separate Financial Statements,* IPSAS 36, IPSAS 37, and IPSAS 38 at the same time.**

79A. **Paragraphs 11, 12 and 13 were deleted and paragraph 8 was amended by *The Applicability of IPSASs*, issued in April 2016. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2018, it shall disclose that fact.**

79B. **Paragraph 6 was amended by IPSAS 39, *Employee Benefits*, issued in July 2016. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2018 it shall disclose that fact and apply IPSAS 39 at the same time.**

79C. **Paragraphs 4, 40, 56, 57 and 63 were amended by IPSAS 40, *Public Sector Combinations*, issued in January 2017. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2019. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2019 it shall disclose that fact and apply IPSAS 40 at the same time.**

79D. **Paragraph 52 was amended and paragraph 55A added by IPSAS 40, *Public Sector Combinations*, issued in January 2017. An entity shall apply these amendments prospectively for annual financial statements covering periods beginning on or after a date to be determined by the IPSASB. Earlier application is permitted. If an entity applies the amendments earlier, it shall disclose that fact and, if it has not already done so, apply IPSAS 40 at the same time.**

79E. **Paragraphs 22, 45, 52, 55A, 56, 58 and AG105 were amended by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply IPSAS 41 at the same time.**

80. When an entity adopts the accrual basis IPSASs as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

Withdrawal and Replacement of IPSAS 6 (December 2006)

81. This Standard is issued concurrently with IPSAS 34. Together, the two Standards supersede IPSAS 6 (December 2006). IPSAS 6 remains applicable until IPSAS 34 and IPSAS 35 are applied or become effective, whichever is earlier.

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 35.

AG1. The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying IPSAS 35, *Consolidated Financial Statements*.

Assessing Control

AG2. To determine whether it controls another entity an entity shall assess whether it has all the following:

(a) Power over the other entity;

(b) Exposure, or rights, to variable benefits from its involvement with the other entity; and

(c) The ability to use its power over the other entity to affect the nature or amount of the benefits from its involvement with the other entity.

AG3. Consideration of the following factors may assist in making that determination:

(a) The purpose and design of the other entity (see paragraphs AG5–AG8);

(b) What the relevant activities are and how decisions about those activities are made (see paragraphs AG13–AG15);

(c) Whether the rights of the entity give it the current ability to direct the relevant activities of the other entity (see paragraphs AG16–AG56);

(d) Whether the entity is exposed, or has rights, to variable benefits from its involvement with the other entity (see paragraph AG57–AG58); and

(e) Whether the entity has the ability to use its power over the other entity to affect the nature or amount of the benefits from its involvement with the other entity (see paragraphs AG60–AG74).

AG4. When assessing whether it controls another entity, an entity shall consider the nature of its relationship with other parties (see paragraphs AG75–AG77).

Purpose and Design of another Entity

AG5. An entity shall consider the purpose and design of the entity being assessed for control in order to identify the relevant activities, how decisions about the relevant activities are made, who has the current ability to direct those activities and who benefits from those activities.

AG6. When the purpose and design of the entity being assessed for control are considered, it may be clear that the entity being assessed for control is controlled by means of equity instruments that give the holder proportionate voting rights, such as ordinary shares. In this case, in the absence of any additional arrangements that alter decision-making, the assessment of control focuses on which party, if any, is able to exercise voting rights sufficient to determine the operating and financing policies of the entity being assessed for control (see paragraphs AG32–AG52). In the most straightforward case, the entity that holds a majority of those voting rights, in the absence of any other factors, controls the other entity.

AG7. To determine whether an entity controls another entity in more complex cases, it may be necessary to consider some or all of the other factors in paragraph AG3.

AG8. Voting rights may not be the dominant factor in deciding who controls the entity being assessed for control. If there are voting rights they may be limited in scope. The relevant activities of the entity being assessed for control may be directed by means of binding arrangements or provisions in founding documents such as articles of association or a constitution. In such cases, an entity's consideration of the purpose and design of the entity being assessed for control shall also include consideration of the risks to which the other entity was designed to be exposed, the risks it was designed to pass on to the parties involved and whether the entity is exposed to some or all of those risks. Consideration of the risks includes not only the downside risk, but also the potential for upside.

Power

AG9. To have power over another entity, an entity must have existing rights that give it the current ability to direct the relevant activities. For the purpose of assessing power, only substantive rights and rights that are not protective shall be considered (see paragraphs AG25–AG31).

AG10. The determination about whether an entity has power depends on the relevant activities, the way decisions about the relevant activities are made and the rights of the entity and other entities in relation to the potentially controlled entity.

AG11. An entity normally will have power over an entity that it has established when the constituting document or enabling legislation specifies the operating and financing activities that are to be carried out by that entity. However, the impact of the constituting document or legislation is evaluated in the light of other prevailing circumstances, as all facts and circumstances need to be considered in assessing whether an entity has power over another entity. For example, a government may not have power over a research and development corporation that operates under a mandate created, and limited, by legislation if that or other legislation assigns power to direct the relevant activities to other entities that are not controlled by the government.

Regulatory Control

AG12. Regulatory control does not usually give rise to power over an entity for the purposes of this Standard. Governments and other public sector bodies, including supranational bodies, may have wide ranging powers to establish the regulatory framework within which entities operate, to impose conditions or sanctions on their operations and to enforce those conditions or sanctions. For example, governments and other public sector bodies may enact regulations to protect the health and safety of the community, restrict the sale or use of dangerous goods or specify the pricing policies of monopolies. However, when regulation is so tight as to effectively dictate how the entity performs its business, then it may be necessary to consider whether the purpose and design of the entity is such that it is controlled by the regulating entity.

Relevant Activities and Direction of Relevant Activities

AG13. For many entities, a range of operating and financing activities significantly affect the benefits they generate. Any activity that assists in achieving or furthering the objectives of a controlled entity may affect the benefits to the controlling entity. Examples of activities that, depending on the circumstances, can be relevant activities include, but are not limited to:

(a) Using assets and incurring liabilities to provide services to service recipients;

(b) Distributing funds to specified individuals or groups;

(c) Collecting revenue through non-exchange transactions;

(d) Selling and purchasing of goods or services;

(e) Managing physical assets;

(f) Managing financial assets during their life (including upon default);

(g) Selecting, acquiring or disposing of assets;

(h) Managing a portfolio of liabilities;

(i) Researching and developing new products or processes; and

(j) Determining a funding structure or obtaining funding.

AG14. Examples of decisions about relevant activities include but are not limited to:

(a) Establishing operating and capital decisions of an entity, including budgets; and

(b) Appointing and remunerating an entity's key management personnel or service providers and terminating their services or employment.

AG15. In some situations, activities both before and after a particular set of circumstances arises or event occurs, may be relevant activities. When two or more entities have the current ability to direct relevant activities and those activities occur at different times, those entities shall determine which entity is able to direct the activities that most significantly affect those benefits consistently with the treatment of concurrent decision-making rights (see paragraph 28). The entities concerned shall reconsider this assessment over time if relevant facts or circumstances change.

Rights that Give an Entity Power over another Entity

AG16. Power arises from rights. To have power over another entity, an entity must have existing rights that give the entity the current ability to direct the relevant activities of the other entity. The rights that may give an entity power can differ.

AG17. Examples of rights that, either individually or in combination, can give an entity power include but are not limited to:

(a) Rights to give policy directions to the governing body of another entity that give the holder the ability to direct the relevant activities of the other entity;

(b) Rights in the form of voting rights (or potential voting rights) of another entity (see paragraphs AG32–AG52);

(c) Rights to appoint, reassign or remove members of another entity's key management personnel who have the ability to direct the relevant activities;

(d) Rights to appoint or remove another entity that directs the relevant activities;

(e) Rights to approve or veto operating and capital budgets relating to the relevant activities of another entity;

(f) Rights to direct the other entity to enter into, or veto any changes to, transactions for the benefit of the entity;

(g) Rights to veto key changes to the other entity, such as the sale of a major asset or of the other entity as a whole; and

(h) Other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.

AG18. In considering whether it has power, an entity will need to consider the binding arrangements that are in place and the mechanism(s) by which it has obtained power. Ways in which an entity may have obtained power, either individually or in combination with other arrangements, include:

(a) Legislative or executive authority;

(b) Administrative arrangements;

(c) Contractual arrangements;

(d) Founding documents (for example, articles of association); and

(e) Voting or similar rights.

AG19. To determine whether an entity has rights sufficient to give it power, the entity shall also consider the purpose and design of the other entity (see paragraphs AG5–AG8) and the requirements in paragraphs AG53–AG56 together with paragraphs AG20–AG22.

AG20. In some circumstances it may be difficult to determine whether an entity's rights are sufficient to give it power over another entity. In such cases, to enable the assessment of power to be made, the entity shall consider evidence of whether it has the practical ability to direct the relevant activities unilaterally. Consideration is given, but is not limited, to the following, which, when considered together with its rights and the indicators in paragraphs AG21 and AG22, may provide evidence that the entity's rights are sufficient to give it power over the other entity:

(a) The entity can, without having the contractual right to do so, appoint or approve the other entity's key management personnel who have the ability to direct the relevant activities;

(b) The entity can, without having the contractual right to do so, direct the other entity to enter into, or can veto any changes to, significant transactions for the benefit of the entity;

(c) The entity can dominate either the nominations process for electing members of the other entity's governing body or the obtaining of proxies from other holders of voting rights;

(d) The other entity's key management personnel are related parties of the entity (for example, the chief executive officer of the other entity and the chief executive officer of the entity are the same person); or

(e) The majority of the members of the other entity's governing body are related parties of the entity.

AG21. Sometimes there will be indications that the entity has a special relationship with the other entity, which suggests that the entity has more than a passive interest in the other entity. The existence of any individual indicator, or a particular combination of indicators, does not necessarily mean that the power criterion is met. However, if an entity has more than a passive interest in another entity this may indicate that the entity has other related rights sufficient to give it power or provide evidence of existing power over another entity. For example, the following suggests that the entity has more than a passive interest in the other entity and, in combination with other rights, may indicate power:

(a) The relationship between the entity and the other entity's operations is one of dependence, such as in the following situations:

(i) The entity funds a significant portion of the other entity's operations and the other entity depends on this.

(ii) The entity guarantees a significant portion of the other entity's obligations, and the other entity depends on this.

(iii) The entity provides critical services, technology, supplies or raw materials to the other entity, and the other entity depends on this.

(iv) The entity controls assets such as licenses or trademarks that are critical to the other entity's operations and the other entity depends on this.

(v) The entity provides key management personnel to the other entity (for example, when the entity's personnel have specialized knowledge of the other entity's operations) and the other entity depends on this.

(b) A significant portion of the other entity's activities either involve or are conducted on behalf of the entity.

(c) The entity's exposure, or rights, to benefits from its involvement with the other entity is disproportionately greater than its voting or other similar rights. For example, there may be a situation in which an entity is entitled, or exposed, to more than half of the benefits of the other entity but holds less than half of the voting rights of the other entity.

AG22. Public sector entities often have special relationships with other parties as a result of the indicators listed in paragraph AG21. Public sector entities often fund the activities of other entities. Economic dependence is discussed in paragraphs AG41 to AG42.

AG23. The greater an entity's exposure, or rights, to variability of benefits from its involvement with another entity, the greater is the incentive for the entity to obtain rights sufficient to give it power. Therefore, having a large exposure to variability of benefits is an indicator that the entity may have power. However, the extent of the entity's exposure does not, in itself, determine whether an entity has power over the other entity.

AG24. When the factors set out in paragraph AG20 and the indicators set out in paragraphs AG21–AG23 are considered together with an entity's rights, greater weight shall be given to the evidence of power described in paragraph AG20.

Substantive Rights

AG25. An entity, in assessing whether it has power, considers only substantive rights relating to another entity (held by the entity and others). For a right to be substantive, the holder must have the practical ability to exercise that right.

AG26. Determining whether rights are substantive requires judgment, taking into account all facts and circumstances. Factors to consider in making that determination include but are not limited to:

(a) Whether there are any barriers (economic or otherwise) that prevent the holder (or holders) from exercising the rights. Examples of such barriers include but are not limited to:

(i) Financial penalties and incentives that would prevent (or deter) the holder from exercising its rights.

(ii) An exercise or conversion price that creates a financial barrier that would prevent (or deter) the holder from exercising its rights.

(iii) Terms and conditions that make it unlikely that the rights would be exercised, for example, conditions that narrowly limit the timing of their exercise.

(iv) The absence of an explicit, reasonable mechanism in the founding documents of another entity or in applicable laws or regulations that would allow the holder to exercise its rights.

(v) The inability of the holder of the rights to obtain the information necessary to exercise its rights.

(vi) Operational barriers or incentives that would prevent (or deter) the holder from exercising its rights (e.g., the absence of other managers willing or able to provide specialized services or provide the services and take on other interests held by the incumbent manager).

(vii) Legal or regulatory requirements that limit the manner in which rights may be exercised or that prevent the holder from exercising its rights (e.g., where another entity has statutory powers which permit it to operate independently of the government or where a foreign entity is prohibited from exercising its rights).

(b) When the exercise of rights requires the agreement of more than one party, or when the rights are held by more than one party, whether a mechanism is in place that provides those parties with the practical ability to exercise their rights collectively if they choose to do so. The lack of such a mechanism is an indicator that the rights may not be substantive. The more parties that are required to agree to exercise the rights, the less likely it is that those rights are substantive. However, a board of directors (or other governing body) whose members are independent of the decision maker may serve as a mechanism for numerous entities (or other parties) to act collectively in exercising their rights. Therefore, removal rights exercisable by an independent board of directors (or other governing body) are more likely to be substantive than if the same rights were exercisable individually by a large number of entities (or other parties).

(c) Whether the party or parties that hold the rights would benefit from the exercise of those rights. For example, the holder of potential voting rights in another entity (see paragraphs AG49–AG52) shall consider the exercise or conversion price of the instrument. The terms and conditions of potential voting rights are more likely to be substantive when the instrument is in the money or the entity would benefit for other reasons (e.g., by realizing synergies between the entity and the other entity) from the exercise or conversion of the instrument.

AG27. To be substantive, rights also need to be exercisable when decisions about the direction of the relevant activities need to be made. Usually, to be substantive, the rights need to be currently exercisable. However, sometimes rights can be substantive, even though the rights are not currently exercisable.

AG28. Substantive rights exercisable by other parties can prevent an entity from controlling the entity being assessed for control, to which those rights relate. Such substantive rights do not require the holders to have the ability to initiate decisions. As long as the rights are not merely protective (see paragraphs AG29–AG31), substantive rights held by other parties may prevent the entity from controlling the entity being assessed for control even if the rights give the holders only the current ability to approve or block decisions that relate to the relevant activities.

Protective Rights

AG29. In evaluating whether rights give an entity power over another entity, the entity shall assess whether its rights, and rights held by others, are protective rights. Protective rights relate to fundamental changes to the activities of another entity or apply in exceptional circumstances. However, not all rights that apply in exceptional circumstances or are contingent on events are protective (see paragraphs AG15 and AG55).

AG30. Because protective rights are designed to protect the interests of their holder without giving that party power over the entity to which those rights relate, an entity that holds only protective rights cannot have power or prevent another party from having power over the entity to which those rights relate (see paragraph 29).

AG31. Examples of protective rights include but are not limited to:

(a) A lender's right to restrict a borrower from undertaking activities that could significantly change the credit risk of the borrower to the detriment of the lender.

(b) The right of a party holding a non-controlling interest in an entity to approve capital expenditure greater than that required in the ordinary course of business, or to approve the issue of equity or debt instruments.

(c) The right of a lender to seize the assets of a borrower if the borrower fails to meet specified loan repayment conditions.

(d) The right of a regulator to curtail or close the operations of entities that are not complying with regulations or other requirements. For example, a pollution control authority may be able to close down activities of an entity that breaches environmental regulations.

(e) The right to remove members of the governing body of another entity under certain restricted circumstances. For example, a state government may be able to remove or suspend the chairman of a municipality and appoint an administrator if the municipality is unable to make timely decisions about key policies.

(f) The right of the government to remove tax deductibility for contributions to a not-for-profit entity if the entity significantly changes its objectives or activities.

(g) The right of an entity providing resources to a charity to demand that, if the charity were to be liquidated, the net assets of the charity would be distributed to an organization undertaking similar activities. (However, if the entity had the power to determine specifically to where the charity's net assets would be distributed upon liquidation, the entity would have substantive rights in relation to the charity).

Voting Rights

AG32. Where an entity has voting or similar rights in respect of another entity, an entity should consider whether those rights give it the current ability to direct the relevant activities of the other entity. An entity considers the requirements in this section (paragraphs AG33–AG52) in making that assessment.

Power with a Majority of the Voting Rights

AG33. An entity that holds more than half of the voting rights of another entity has power in the following situations, unless paragraph AG34 or paragraph AG35 applies:

(a) The relevant activities are directed by a vote of the holder of the majority of the voting rights; or

(b) A majority of the members of the governing body that directs the relevant activities are appointed by a vote of the holder of the majority of the voting rights.

Majority of the Voting Rights but no Power

AG34. For an entity that holds more than half of the voting rights of another entity, to have power over that other entity, the entity's voting rights must be substantive, in accordance with paragraphs AG25–AG28, and must provide the entity with the current ability to direct the relevant activities, which often will be through determining operating and financing policies. If another entity has existing rights that provide that entity with the right to direct the relevant activities and that entity is not an agent of the entity making the assessment of control, the entity making the assessment of control does not have power over the other entity.

AG35. An entity does not have power over another entity, even though the entity holds the majority of the voting rights in the other entity, when those voting rights are not substantive. For example, an entity that has more than half of the voting rights in another entity cannot have power if the relevant activities are subject to direction by a government, court, administrator, receiver, liquidator or regulator.

Power without a Majority of the Voting Rights

AG36. An entity can have power even if it holds less than a majority of the voting rights of another entity. An entity can have power with less than a majority of the voting rights of another entity, for example, through:

(a) The power to appoint or remove a majority of the members of the board of directors (or other governing body), and control of the other entity is by that board or by that body (see paragraph AG38);

(b) A binding arrangement between the entity and other vote holders (see paragraph AG39);

(c) Rights arising from other binding arrangements (see paragraph AG40);

(d) The entity's voting rights (see paragraphs AG37 and AG43–AG48);

(e) Potential voting rights (see paragraphs AG49–AG52); or

(f) A combination of (a)–(e).

Special Voting Rights Attaching to Ownership Interests (Golden Shares)

AG37. An entity may have the right of decisive vote, thus to veto all other voting rights of another entity. This type of right is sometimes referred to as a "golden share". Such special voting rights may give rise to power. Usually these rights are documented in the founding documents of the other entity (such as articles of association), and are designed to restrict the level of voting or other rights that may be held by certain parties. They may also give an entity veto powers over any major change in the other entity, such as the sale of a major asset or the sale of the other entity as a whole.

Control of the Board or Other Governing Body

AG38. An entity may have the power to appoint or remove a majority of the members of the board of directors (or other governing body) as a result of binding arrangements (including existing legislation, executive authority, regulation, contractual, or other arrangements).

Binding Arrangement with Other Vote Holders

AG39. A binding arrangement between an entity and other vote holders can give the entity the right to exercise voting rights sufficient to give the entity power, even if the entity does not have voting rights sufficient to give it power without the binding arrangement. However, a binding arrangement might ensure that the entity can direct enough other vote holders on how to vote to enable the entity to make decisions about the relevant activities.

Rights from Other Binding Arrangements

AG40. Other decision-making rights, in combination with voting rights, can give an entity the current ability to direct the relevant activities. For example, the rights specified in a binding arrangement in combination with voting rights may give an entity the current ability to direct the operating or financing policies or other key activities of another entity that significantly affect the benefits received by the entity. However, an entity would not control another entity if that other entity were able to determine its policy or program to a significant extent, (for example, by failing to comply with the binding arrangement and accepting the consequences, or by changing its constitution or dissolving itself).

Economic Dependence

AG41. Economic dependence, alone, does not give rise to power over an entity for the purposes of this Standard. Economic dependence may occur when:

(a) An entity has a single major client and the loss of that client could affect the existence of the entity's operations; or

(b) An entity's activities are predominantly funded by grants and donations and it receives the majority of its funding from a single entity.

AG42. An entity may be able to influence the financial and operating policies of another entity that is dependent on it for funding. However, a combination of factors will need to be considered to determine whether the economic dependence is such that the economically dependent entity no longer has the ultimate power to govern its own financial or operating policies. If an economically dependent entity retains discretion as to whether it will take funding from an entity, or do business with an entity, the economically dependent entity still has the ultimate power to govern its own financial or operating policies. For example, a private school that accepts funding from a government but whose governing body has retained discretion with respect to accepting funds or the manner in which those funds are to be used, would still have the ultimate power to govern its own financial or operating policies. This may be so even if government grants provided to such an entity requires it to comply with specified conditions. Although the entity might receive government grants for the construction of capital assets and operating costs subject to specified service standards or restrictions on user fees, its governing bodies may have ultimate discretion about how assets are used; the entity would therefore control its financial and operating policies. It is also important to distinguish between the operations of an entity and an entity itself. The loss of a major client might affect the viability of the operations of an entity but not the existence of the entity itself.

The Entity's Voting Rights

AG43. An entity with less than a majority of the voting rights has rights that are sufficient to give it power when the entity has the practical ability to direct the relevant activities unilaterally.

AG44. When assessing whether an entity's voting rights are sufficient to give it power, an entity considers all facts and circumstances, including:

(a) The size of the entity's holding of voting rights relative to the size and dispersion of holdings of the other vote holders, noting that:

 (i) The more voting rights an entity holds, the more likely the entity is to have existing rights that give it the current ability to direct the relevant activities;

 (ii) The more voting rights an entity holds relative to other vote holders, the more likely the entity is to have existing rights that give it the current ability to direct the relevant activities;

 (iii) The more parties that would need to act together to outvote the entity, the more likely the entity is to have existing rights that give it the current ability to direct the relevant activities;

(b) Potential voting rights held by the entity, other vote holders or other parties (see paragraphs AG49–AG52);

(c) Rights arising from other binding arrangements (see paragraph AG40); and

(d) Any additional facts and circumstances that indicate the entity has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

AG45. When the direction of relevant activities is determined by majority vote and an entity holds significantly more voting rights than any other vote holder or organized group of vote holders, and the other shareholdings are widely dispersed, it may be clear, after considering the factors listed in paragraph AG44(a)–(c) alone, that the entity has power over the other entity.

AG46. In other situations, it may be clear after considering the factors listed in paragraph AG44(a)–(c) alone that an entity does not have power.

AG47. However, the factors listed in paragraph AG44(a)–(c) alone may not be conclusive. If an entity, having considered those factors, is unclear whether it has power, it shall consider additional facts and circumstances, such as whether other shareholders are passive in nature as demonstrated by voting patterns at previous shareholders' meetings. This includes the assessment of the factors set out in paragraph AG20 and the indicators in paragraphs AG21–AG23. The fewer voting rights the entity holds, and the fewer parties that would need to act together to outvote the entity, the more reliance would be placed on the additional facts and circumstances to assess whether the entity's rights are sufficient to give it power. When the facts and circumstances in paragraphs AG20–AG23 are considered together with the entity's rights, greater weight shall be given to the evidence of power in paragraph AG20 than to the indicators of power in paragraphs AG21–AG23.

AG48. If it is not clear, having considered the factors listed in paragraph AG44(a)–(d), that the entity has power, the entity does not control the other entity.

Potential Voting Rights

AG49. When assessing control, an entity considers its potential voting rights as well as potential voting rights held by other parties, to determine whether it has power. Potential voting rights are rights to obtain voting rights of another entity, such as those arising from convertible instruments or options, including forward contracts. Those potential voting rights are considered only if the rights are substantive (see paragraphs AG25–AG28).

AG50. When considering potential voting rights, an entity shall consider the purpose and design of the instrument, as well as the purpose and design of any other involvement the entity has with the other entity. This includes an assessment of the various terms and conditions of the instrument as well as the entity's apparent expectations, motives and reasons for agreeing to those terms and conditions.

AG51. If the entity also has voting or other decision-making rights relating to the other entity's activities, the entity assesses whether those rights, in combination with potential voting rights, give the entity power.

AG52. Substantive potential voting rights alone, or in combination with other rights, can give an entity the current ability to direct the relevant activities. For example, this is likely to be the case when an entity holds 40 per cent of the voting rights of another entity and, in accordance with paragraph AG26, holds substantive rights arising from options to acquire a further 20 per cent of the voting rights.

Power when Voting or Similar Rights do not have a Significant Effect on Benefits

AG53. In assessing the purpose and design of another entity (see paragraphs AG5–AG8), an entity shall consider the involvement and decisions made at the inception of the other entity as part of its design and evaluate whether the transaction terms and features of the involvement provide the entity with rights that are sufficient to give it power. Being involved in the design of another entity alone is not sufficient to give an entity control of that other entity. However, involvement in the design of the other entity may indicate that the entity had the opportunity to obtain rights that are sufficient to give it power over the other entity and hence the ability to determine the purpose and design of an entity may give rise to power. In the case of an entity established with most (or all) of its relevant activities predetermined at inception, having the ability to determine the purpose and design of an entity may be more relevant to the control assessment than any on-going decision-making rights.

AG54. In addition, an entity shall consider rights arising from binding arrangements such as call rights, put rights, liquidation rights and rights arising from legislative or executive authority established at the inception of the other entity. When binding arrangements involve activities that are closely related to the other entity, then these activities are, in substance, an integral part of the other entity's overall activities, even though they may occur outside the legal boundaries of the other entity. Therefore, explicit or implicit decision-making rights embedded in binding arrangements that are closely related to the other entity need to be considered as relevant activities when determining power over the other entity.

AG55. For some other entities, relevant activities occur only when particular circumstances arise or events occur. The other entity may be designed so that the direction of its activities and the benefits from those activities are predetermined unless and until those particular circumstances arise or events occur. In this case, only the decisions about the other entity's activities when those circumstances or events occur can significantly affect its benefits and thus be relevant activities. The circumstances or events need not have occurred for an entity with the ability to make those decisions to have power. The fact that the right to make decisions is contingent on circumstances arising or an event occurring does not, in itself, make those rights protective.

AG56. An entity may have an explicit or implicit commitment to ensure that another entity continues to operate as designed. Such a commitment may increase the entity's exposure to variability of benefits and thus increase the incentive for the entity to obtain rights sufficient to give it power. Therefore a commitment to ensure that another entity operates as designed may be an indicator that the entity has power, but does not, by itself, give an entity power, nor does it prevent another party from having power.

Exposure, or Rights, to Variable Benefits from another Entity

AG57. When assessing whether an entity has control of another entity, the entity determines whether it is exposed, or has rights, to variable benefits from its involvement with the other entity.

AG58. Variable benefits are benefits that are not fixed and have the potential to vary as a result of the performance of another entity. Variable benefits can be only positive, only negative or both positive and negative (see paragraph 30). An entity assesses whether benefits from another entity are variable and how variable those benefits are on the basis of the substance of the arrangement and regardless of the legal form of the benefits. For example:

(a) In the context of non-financial benefits an entity may receive benefits as a result of the activities of another entity furthering its objectives. The benefits may be variable benefits for the purpose of this Standard because they may expose the entity to the performance risk of the other entity. If the other entity were unable to perform those activities then the entity might incur additional costs, either from undertaking the activities itself or by providing additional funds or other forms of assistance to enable the other entity to continue providing those activities.

(b) In the context of financial benefits an entity can hold a bond with fixed interest payments. The fixed interest payments are variable benefits for the purpose of this Standard because they are subject to default risk and they expose the entity to the credit risk of the issuer of the bond. The amount of variability (i.e., how variable those benefits are) depends on the credit risk of the bond. Similarly, fixed performance fees for managing another entity's assets are variable benefits because they expose the entity to the performance risk of the other entity. The amount of variability depends on the other entity's ability to generate sufficient revenue to pay the fee.

AG59. A liquidator would not normally have rights to variable benefits from its involvement with the entity being liquidated.

Link between Power and Benefits

Delegated Power

AG60. It is common for public sector entities to be responsible for carrying out government policy. In some cases they may have the authority to act in their own right, in other cases they may act as an agent for a Minister or another entity. For example:

(a) A government department, which is authorized by a Minister to act on the Minister's behalf, might act solely as an agent of the responsible Minister in relation to another entity. In such cases the department would not control the other entity and would not consolidate it.

(b) A government department may operate under a delegation of power from a Minister. The department uses its own discretion in making decisions and taking actions and is not subject to direction from the Minister. In such cases the department is acting in its own right and would need to apply the other requirements of this Standard to determine whether it controlled another entity. The scope of the department's decision-making authority over another entity would be a significant factor in distinguishing whether it is acting as an agent or as a principal.

(c) An entity may establish a trust to carry out specified activities and appoints the trustee. The trustee is responsible for making decisions about the financing and operating activities of the trust in accordance with the trust deed. If the entity can replace the trustee at its discretion, the entity would need to assess whether it controls the trust given that, for example, it would be exposed, or have rights, to variable benefits in terms of the extent to which its objectives are achieved or furthered through the activities of the trust.

AG61. An entity may delegate its decision-making authority to an agent on some specific issues or on all relevant activities. When assessing whether it controls another entity, the entity shall treat the decision-making rights delegated to its agent as held by the entity directly. In situations where there is more than one principal, each of the principals shall assess whether it has power over the other entity by considering the requirements in paragraphs AG5–AG56.Paragraphs AG62–AG74 provide guidance on determining whether a decision maker is an agent or a principal.

AG62. A decision maker shall consider the overall relationship between itself, the other entity being managed (and assessed for control) and other parties involved with that entity. In particular, a decision maker shall consider all the factors below, in determining whether it is an agent:

(a) The scope of its decision-making authority over the other entity (paragraphs AG64 and AG65);

(b) The rights held by other parties (paragraphs AG66–AG69);

(c) The remuneration to which it is entitled in accordance with the remuneration agreement(s) (paragraphs AG70–AG72); and

(d) The decision maker's exposure to variability of benefits from other interests that it holds in the other entity (paragraphs AG73 and AG74).

Different weightings shall be applied to each of the factors on the basis of particular facts and circumstances.

AG63. Determining whether a decision maker is an agent requires an evaluation of all the factors listed in paragraph AG62 unless a single party holds substantive rights to remove the decision maker (removal rights) and can remove the decision maker without cause (see paragraph AG67).

The Scope of the Decision-Making Authority

AG64. The scope of a decision maker's decision-making authority is evaluated by considering:

(a) The activities that are permitted according to the decision-making agreement(s) and specified by law, and

(b) The discretion that the decision maker has when making decisions about those activities.

AG65. A decision maker shall consider the purpose and design of the other entity, the risks to which the other entity was designed to be exposed, the risks it was designed to pass on to the parties involved and the level of involvement the decision maker had in the design of another entity. For example, if a decision maker is significantly involved in the design of the other entity (including in determining the scope of decision-making authority), that involvement may indicate that the decision maker had the opportunity and incentive to obtain rights that result in the decision maker having the ability to direct the relevant activities.

Rights held by Other Parties

AG66. Substantive rights held by other parties may affect the decision maker's ability to direct the relevant activities of another entity. Substantive removal or other rights may indicate that the decision maker is an agent.

AG67. When a single party holds substantive removal rights and can remove the decision maker without cause, this, in isolation, is sufficient to conclude that the decision maker is an agent. If more than one party holds such rights (and no individual party can remove the decision maker without the agreement of other parties) those rights are not, in isolation, conclusive in determining that a decision maker acts primarily on behalf and for the benefit of others. In addition, the greater the number of parties required to act together to exercise rights to remove a decision maker and the greater the magnitude of, and variability associated with, the decision maker's other economic interests (i.e., remuneration and other interests), the less the weighting that shall be placed on this factor.

AG68. Substantive rights held by other parties that restrict a decision maker's discretion shall be considered in a similar manner to removal rights when evaluating whether the decision maker is an agent. For example, a decision maker that is required to obtain approval from a small number of other parties for its actions is generally an agent. (See paragraphs AG25–AG28 for additional guidance on rights and whether they are substantive).

AG69. Consideration of the rights held by other parties shall include an assessment of any rights exercisable by another entity's board of directors (or other governing body) and their effect on the decision-making authority (see paragraph AG26(b)).

Remuneration

AG70. The greater the magnitude of, and variability associated with, the decision maker's remuneration relative to the benefits expected from the activities of the other entity, the more likely the decision maker is a principal.

AG71. In determining whether it is a principal or an agent the decision maker shall also consider whether the remuneration agreement includes only terms, conditions or amounts that are customarily present in arrangements for similar services and level of skills negotiated on an arm's length basis.

AG72. A decision maker cannot be an agent unless the conditions set out in paragraph AG74(a) and (b) are present. However, meeting those conditions in isolation is not sufficient to conclude that a decision maker is an agent.

Exposure to Variability of Benefits from Other Interests

AG73. A decision maker that holds other interests in another entity (e.g., investments in the other entity or provides guarantees with respect to the performance of the other entity), shall consider its exposure to variability of benefits from those interests in assessing whether it is an agent. Holding other interests in another entity indicates that the decision maker may be a principal.

AG74. In evaluating its exposure to variability of benefits from other interests in the other entity a decision maker shall consider the following:

(a) The greater the magnitude of, and variability associated with, its economic interests, considering its remuneration and other interests in aggregate, the more likely the decision maker is a principal.

(b) Whether its exposure to variability of benefits is different from that of the other entities that receive benefits from the entity being assessed for control and, if so, whether this might influence its actions. For example, this might be the case when a decision maker holds subordinated interests in, or provides other forms of credit enhancement to, another entity.

The decision maker shall evaluate its exposure relative to the total variability of benefits of the other entity. This evaluation is made primarily on the basis of benefits expected from the activities of the other entity but shall not ignore the decision maker's maximum exposure to variability of benefits of the other entity through other interests that the decision maker holds.

Relationship with Other Parties

AG75. When assessing control, an entity shall consider the nature of its relationship with other parties and whether those other parties are acting on the entity's behalf (i.e., they are "de facto agents"). The determination of whether other parties are acting as de facto agents requires judgment, considering not only the nature of the relationship but also how those parties interact with each other and the entity.

AG76. Such a relationship need not involve a binding arrangement. Such relationships could also arise from legislative or executive authority that does not meet the definition of a binding arrangement. A party is a de facto agent when the entity has, or those that direct the activities of the entity have, the ability to direct that party to act on the entity's behalf. In these circumstances, the entity shall consider its de facto agent's decision-making rights and its indirect exposure, or rights, to variable benefits through the de facto agent together with its own when assessing control of another entity.

AG77. The following are examples of such other parties that, by the nature of their relationship, might act as de facto agents for the entity:

(a) The entity's related parties.

(b) A party that received its interest in the other entity as a contribution or loan from the entity making the assessment of control.

(c) A party that has agreed not to sell, transfer or encumber its interests in the other entity without the entity's prior approval (except for situations in which the entity and the other party have the right of prior approval and the rights are based on mutually agreed terms by willing independent parties).

(d) A party that cannot finance its operations without subordinated financial support from the entity.

(e) Another entity for which the majority of the members of its governing body or for which its key management personnel are the same as those of the entity.

(f) A party that has a close business relationship with the entity, such as the relationship between a professional service provider and one of its significant clients.

Control of Specified Assets

AG78. An entity shall consider whether it treats a portion of another entity as a deemed separate entity and, if so, whether it controls the deemed separate entity.

AG79. An entity shall treat a portion of another entity as a deemed separate entity if and only if the following condition is satisfied:

Specified assets of the other entity (and related credit enhancements, if any) are the only source of payment for specified liabilities of, or specified other interests in, the other entity. Parties other than those with the specified liability do not have rights or obligations related to the specified assets or to residual cash flows from those assets. In substance, none of the benefits from the specified assets can be used by the remaining portion of the other entity and none of the liabilities of the deemed separate entity are payable from the assets of the remainder of the other entity. Thus, in substance, all the assets, liabilities and equity instruments of that deemed separate entity are ring-fenced from the overall other entity. Such a deemed separate entity is often called a "silo".

AG80. When the condition in paragraph AG79 is satisfied, an entity shall identify the activities that significantly affect the benefits of the deemed separate entity and how those activities are directed in order to assess whether it has power over that portion of the other entity. When assessing control of the deemed separate entity, the entity shall also consider whether it has exposure or rights to variable benefits from its involvement with that deemed separate entity and the ability to use its power over that portion of the other entity to affect the amount of the benefits from that entity.

AG81. If the entity controls the deemed separate entity, the entity shall consolidate that portion of the other entity. In that case, other parties exclude that portion of the other entity when assessing control of, and in consolidating, the other entity.

Continuous Assessment

AG82. An entity shall reassess whether it controls another entity if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 20.

AG83. If there is a change in how power over another entity can be exercised, that change must be reflected in how an entity assesses its power over another entity. For example, changes to decision-making rights can mean that the relevant activities are no longer directed through voting rights, but instead other agreements, such as contracts, give another party or parties the current ability to direct the relevant activities.

AG84. An event can cause an entity to gain or lose power over another entity without the entity being involved in that event. For example, an entity can gain power over another entity because decision-making rights held by another party or parties that previously prevented the entity from controlling another entity have lapsed.

AG85. An entity also considers changes affecting its exposure, or rights, to variable benefits from its involvement with another entity. For example, an entity that has power over another entity can lose control of that other entity if the entity ceases to be entitled or have the ability to receive benefits or to be exposed to obligations, because the entity would fail to satisfy paragraph 20(b) (e.g., if a contract to receive performance-related fees is terminated).

AG86. An entity shall consider whether its assessment that it acts as an agent or a principal has changed. Changes in the overall relationship between the entity and other parties can mean that an entity no longer acts as an agent, even though it has previously acted as an agent, and vice versa. For example, if changes to the rights of the entity, or of other parties, occur, the entity shall reconsider its status as a principal or an agent.

AG87. An entity's initial assessment of control or its status as a principal or an agent would not change simply because of a change in market conditions (e.g., a change in the other entity's benefits driven by market conditions), unless the change in market conditions changes one or more of the three elements of control listed in paragraph 20 or changes the overall relationship between a principal and an agent.

Determining Whether an Entity is an Investment Entity

AG88. An entity shall consider all facts and circumstances when assessing whether it is an investment entity, including its purpose and design. Paragraphs AG89–AG106 describe aspects of the definition of an investment entity in more detail.

Number of Investors

AG89. The definition of an investment entity requires that the entity have one or more investors. An investment entity may have several investors who pool their funds to gain access to investment management services and investment opportunities that they might not have had access to individually. Having several investors would make it less likely that the entity, or other members of the economic entity containing the entity, would obtain benefits other than capital appreciation or investment revenue.

AG90. However, in the public sector it is also common for an investment entity to be formed by, or for, a single controlling entity that represents or supports the interests of a wider group of investors (e.g., a pension fund, government investment fund or trust).

Ownership Interests

AG91. An investment entity is typically, but is not required to be, a separate legal entity. The investors in an investment entity will often, but not always, have ownership interests in the form of equity or similar interests (e.g., partnership interests), to which proportionate shares of the net assets of the investment entity are attributed. The definition of an investment entity does not specify that all investors must have the same rights. Having different classes of investors, some of which have rights only to a specific investment or groups of investments or which have different proportionate shares of the net assets, does not preclude an entity from being an investment entity.

AG92. The definition of an investment entity does not specify that the investors must have an ownership interest that meets the definition of net assets/equity in accordance with other applicable IPSASs. An entity that has significant ownership interests in the form of debt that does not meet the definition of net assets/equity may still qualify as an investment entity, provided that the debt holders are exposed to variable returns from changes in the fair value of the entity's net assets.

Purpose

AG93. The definition of an investment entity requires that the purpose of the entity is to invest solely for returns from capital appreciation, investment revenue (such as dividends or similar distributions, interest or rental revenue), or both. Documents that indicate what the entity's investment objectives are, such as the entity's mandate, constitution, offering memorandum, publications distributed by the entity and other corporate or partnership documents, will typically provide evidence of an investment entity's purpose. Further evidence may include the manner in which the entity presents itself to other parties; for example, an entity may present its objective as providing medium-term investment for capital appreciation.

AG94. An entity that has additional objectives that are inconsistent with the purpose of an investment entity would not meet the definition of an investment entity. Examples of when this may occur are as follows:

(a) An investor whose objective is to jointly develop, produce or market products with its investees. The entity will earn returns from the development, production or marketing activity as well as from its investments;

(b) An investor whose objectives require it to be aligned with the economic, social or environmental policies of another entity. For example, if an entity is required to align its investment policies with other objectives such as owning certain businesses or improving employment outcomes in a jurisdiction; and

(c) An investor whose individual investment decisions have to be ratified or approved by a controlling entity or which is required to follow the direction of a controlling entity. Such ratifications, approvals or decisions are likely to be inconsistent with the purpose of an investment entity.

AG95. An entity's purpose may change over time. In assessing whether it continues to meet the definition of an investment entity, an entity would need to have regard to any changes in the environment in which it operates and the impact of such changes on its investment strategy.

Demonstrating Purpose through Holding More than One Investment

AG96. An investment entity may have a number of ways in which it can demonstrate that its purpose is to invest funds for capital appreciation, investment revenue or both. One way is by holding several investments to diversify its risk and maximize its returns. An entity may hold a portfolio of investments directly or indirectly, for example by holding a single investment in another investment entity that itself holds several investments.

AG97. There may be times when the entity holds a single investment. However, holding a single investment does not necessarily prevent an entity from meeting the definition of an investment entity. For example, an investment entity may hold only a single investment when the entity:

(a) Is in its start-up period and has not yet identified suitable investments and, therefore, has not yet executed its investment plan to acquire several investments;

(b) Has not yet made other investments to replace those it has disposed of;

(c) Is established to pool investors' funds to invest in a single investment when that investment is unobtainable by individual investors (e.g., when the required minimum investment is too high for an individual investor); or

(d) Is in the process of being disestablished.

Investment-Related Services and Activities

AG98. An investment entity may provide investment-related services (e.g., investment advisory services, investment management, investment support and administrative services), either directly or through a controlled entity, to third parties as well as to its controlling entity or other investors, even if those activities are substantial to the entity, subject to the entity continuing to meet the definition of an investment entity.

AG99. An investment entity may also participate in the following investment-related activities, either directly or through a controlled entity, if these activities are undertaken to maximize the investment return (capital appreciation or investment revenue) from its investees and do not represent a separate substantial activity or a separate substantial source of revenue to the investment entity:

(a) Providing management services and strategic advice to an investee; and

(b) Providing financial support to an investee, such as a loan, capital commitment or guarantee.

AG100. If an investment entity has a controlled entity that is not itself an investment entity and whose main purpose and activities are providing investment-related services or activities that relate to the investment entity's investment activities, such as those described in paragraphs AG98–AG99, to the entity or other parties, it shall consolidate that controlled entity in accordance with paragraph 57. If the controlled entity that provides the investment-related services or activities is itself an investment entity, the controlling investment entity shall measure that controlled entity at fair value through surplus or deficit in accordance with paragraph 56.

Exit Strategies

AG101. An entity's investment plans also provide evidence of its purpose. One feature that differentiates an investment entity from other entities is that an investment entity does not plan to hold its investments indefinitely; it holds them for a limited period. Because equity investments and non-financial asset investments have the potential to be held indefinitely, an investment entity shall have an exit strategy documenting how the entity plans to realize capital appreciation from substantially all of its equity investments and non-financial asset investments. An investment entity shall also have an exit strategy for any debt instruments that have the potential to be held indefinitely, for example perpetual debt investments. The entity need not document specific exit strategies for each individual investment but shall identify different potential strategies for different types or portfolios of investments, including a substantive time frame for exiting the investments. Exit mechanisms that are only put in place for default events, such as a breach of contract or non-performance, are not considered exit strategies for the purpose of this assessment.

AG102. Exit strategies can vary by type of investment. For investments in private equity securities, examples of exit strategies include an initial public offering, a private placement, a trade sale of a business, distributions (to investors) of ownership interests in investees and sales of assets (including the sale of an investee's assets followed by a liquidation of the investee). For equity investments that are traded in a public market, examples of exit strategies include selling the investment in a private placement or in a public market. For real estate investments, an example of an exit strategy includes the sale of the real estate through specialized property dealers or the open market.

AG103. An investment entity may have an investment in another investment entity that is formed in connection with the entity for legal, regulatory, tax or similar business reasons. In this case, the investment entity investor need not have an exit strategy for that investment, provided that the investment entity investee has appropriate exit strategies for its investments.

Fair Value Measurement

AG104. An essential element of the definition of an investment entity is that it measures and evaluates the performance of substantially all of its investments on a fair value basis, because using fair value results in more relevant information than, for example, consolidating its controlled entities or using the equity method for its interests in associates or joint ventures. In order to demonstrate that it meets this element of the definition, an investment entity:

(a) Provides investors with fair value information and measures substantially all of its investments at fair value in its financial statements whenever fair value is required or permitted in accordance with IPSASs; and

(b) Reports fair value information internally to the entity's key management personnel (as defined in IPSAS 20, *Related Party Disclosures*), who use fair value as the primary measurement attribute to evaluate the performance of substantially all of its investments and to make investment decisions.

AG105. In order to meet the requirement in AG104(a), an investment entity would:

(a) Elect to account for any investment property using the fair value model in IPSAS 16, *Investment Property*;

(b) Elect the exemption from applying the equity method in IPSAS 36 for its investments in associates and joint ventures; and

(c) Measure its financial assets at fair value using the requirements in IPSAS 41.

AG106. An investment entity may have some non-investment assets, such as a head office property and related equipment, and may also have financial liabilities. The fair value measurement element of the definition of an investment entity applies to an investment entity's investments. Accordingly, an investment entity need not measure its non-investment assets or its liabilities at fair value.

Appendix B

Amendments to Other IPSASs

[Deleted]

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 35.

Objective

BC1. This Basis for Conclusions summarizes the IPSASB's considerations in reaching the conclusions in IPSAS 35. As this Standard is based on IFRS 10, *Consolidated Financial Statements* (issued in 2011, including amendments up to December 31, 2014) issued by the IASB, the Basis for Conclusions outlines only those areas where IPSAS 35 departs from the main requirements of IFRS 10, or where the IPSASB considered such departures.

Overview

BC2. In 2012 the IPSASB commenced work on a project to update those IPSASs that dealt with accounting for interests in controlled entities, associates and joint ventures. In October 2013 the IPSASB issued Exposure Drafts (EDs) 48 to 52 which were collectively referred to as *Interests in Other Entities*. ED 49 *Consolidated Financial Statements* was based on IFRS 10 *Consolidated Financial Statements*, having regard to the relevant public sector modifications in IPSAS 6, *Consolidated and Separate Financial Statements*. In January 2015 the IPSASB issued five new IPSASs, including IPSAS 35. These new IPSASs supersede IPSAS 6, IPSAS 7, *Investments in Associates* and IPSAS 8, *Interests in Joint Ventures.*

Process

BC3. In developing the Standard the IPSASB had regard to those aspects of IPSAS 6 that had been developed specially to address public sector issues or circumstances that are more prevalent in the public sector than in other sectors. The IPSASB focused on addressing these issues in the Standard. The IPSASB also had regard to the guidance on assessing whether an entity is controlled for the purposes of the *Government Finance Statistics Manual* 2014 (GFSM 2014) with the aim of avoiding unnecessary differences. In developing additional examples that illustrated the public sector environment the IPSASB also considered guidance developed by national standard setters or by bodies with oversight responsibilities for sectors of government.

Alignment with Government Finance Statistics

BC4. Both at the time of developing ED 49, and as part of the process of finalizing the Standard, the IPSASB considered an analysis of similarities and differences between the definition of control, together with the associated indicators and guidance in GFSM 2014 (and the 2008 System of National Accounts (2008 SNA) with which the GFSM 2014 is harmonized) and the proposed Standard. The IPSASB noted that some of the differences between GFSM and financial reporting are due to their nature and differing objectives. For example, the classification of institutional units into sectors based on their economic nature of being government units will continue to be a significant difference between macroeconomic statistical reporting and accounting and financial reporting. Furthermore, the distinction between market producers and nonmarket producers in macroeconomic statistics would continue to result in a difference in terms of classification to either the general government sector or the public corporations sector, and therefore the overall classification to the public sector, even if there was exactly the same principle and conceptual guidance on the notion of control.

BC5. During the development of the Standard the IPSASB made a number of efforts to align more closely with guidance in GFSM 2014 or to explain more clearly the nature of differences. Issues in respect of which the IPSASB specifically considered GFSM requirements included:

(a) Whether to require the consolidation of all controlled entities, as opposed to reporting by sectors of government;

(b) The similarity between the concept of control in the Standard and the approach taken in GFSM 2014, including consideration of the indicators of control of nonprofit institutions and corporations in 2008 SNA;

(c) The differences between regulatory control and control for financial reporting purposes; and;

(d) The rights associated with golden shares.

Some of these matters are discussed in more detail in later sections of this Basis for Conclusions.

Scope (paragraphs 3–11)

Wholly-Owned and Partly-Owned Controlling Entities

BC6. The IPSASB agreed that, consistent with the requirements in IPSAS 6 and IFRS 10, wholly-owned or partly-owned controlling entities that meet certain conditions, and post-employment or other long-term employee benefit plans should not be required to present consolidated financial statements. The IPSASB decided that a controlling entity which itself is a controlled entity should not be required to present consolidated financial statements only if "users of such financial statements are unlikely to exist or their information needs are met by the controlling entity's consolidated financial statements". This limitation is intended to protect users where such controlling entities represent key sectors or activities of a government and there are users that need consolidated financial statements for accountability or decision making purposes.

Application of the Consolidation Requirements to all Controlled Entities

BC7. The IPSASB noted the general principle in both IFRS 10 and IPSAS 6 that a controlling entity should consolidate, on a line by line basis, all of its controlled entities. The IPSASB noted that over recent years the potential scale and complexity of a public sector entity's involvement with other entities (particularly the relationships between a government and other entities) had increased. Government interventions had been a contributing factor to governments (and other public sector entities) having a broad range of interests in other entities, some of which could give rise to control as defined in this Standard. The implications of consolidation when a government has a large number of controlled entities, controlled entities carrying out activities that were formerly regarded as solely private sector activities, and controlled entities where control is intended to be temporary, had led some to query whether consolidation of all controlled entities was justified, having regard to the costs and benefits of doing so.

BC8. The IPSASB deliberated extensively on the issue of whether all controlled entities should be consolidated, having regard to users' needs. The IPSASB focused on the information provided by consolidated financial statements, whilst noting that users' information needs may also be met through other statements and reports such as (i) separate financial statements of both controlling and controlled entities; (ii) performance reports; and (iii) statistical reports. Although some of the IPSASB's discussions were relevant to any type of public sector entity that is a controlling entity, many of the matters considered were more pertinent at the whole of government level. The IPSASB considered views on the usefulness of consolidation in relation to the following types of controlled entities (whilst noting that these broad categories would not be universally applicable):

(a) Departments and ministries;

(b) Government agencies;

(c) [Government Business Enterprises (GBE)] (the term in square brackets is no longer used following the issue of *The Applicability of IPSASs* in April 2016);

(d) Financial institutions (excluding government sponsored enterprises); and

(e) Other investments (including intentional investments, incidental investments and investment entities).The term "incidental investments" was used to refer to interests acquired in the course of meeting another objective, such as preventing the collapse of a private sector entity.

BC9. The IPSASB noted that, although there was general agreement that consolidation of controlled departments and ministries and government agencies is appropriate, some members were less certain that the cost of preparing consolidated financial information was justified for other categories of controlled entities.

BC10. The IPSASB noted arguments in support of requiring consolidation of all controlled entities of a government, including the following:

(a) Consolidated financial statements provide a panoramic view of a government's activities and current financial position. This panoramic view ensures that users do not lose sight of the risks associated with certain sectors. It shows the performance of the government as a whole.

(b) Identifying categories of entities which should not be consolidated could be difficult. Such attempts could lead to rules-based standards. For example, there could be difficulties in separately identifying entities rescued from financial distress on a consistent basis across jurisdictions and over time. Similar issues could arise in respect of any separate proposals for GBEs. Although the term GBE was a defined term within IPSASs when this Standard was issued, the IPSASB noted that there were differences in the way this definition is being applied in practice in different jurisdictions. In addition to the issue of clearly identifying any group of entities for which different accounting requirements would be appropriate, the IPSASB noted that similar activities can be conducted by a variety of entity types both within and across jurisdictions. So, although proposals for different accounting treatments might lead to consistent treatment for a group of entities within a jurisdiction, it might not result in comparable accounting for similar activities.

(c) Consolidation of all controlled entities is an example of like items being accounted for in like ways. Exceptions to consolidation reduce the coherence of the financial statements. Given that there could be a number of entities that could potentially be regarded as warranting separate treatment or disclosure, this could adversely affect the coherence of consolidated financial statements.

(d) Whole of government financial statements have a different perspective from separate financial statements. Separate financial statements provide information on the activities of the core government.

BC11. The IPSASB also noted arguments that have been raised in opposition to consolidation of certain controlled entities of a government, including the following:

(a) The consolidation of entities that have activities that differ from the activities of the core government could obscure the presentation of the results and the condition of the government itself. This argument was raised in relation to a variety of controlled entities including manufacturing activities, large financial institutions, temporarily controlled entities and entities with financial objectives as opposed to social objectives.

(b) Some consider that equity accounting for certain categories of controlled entities provides appropriate information on financial performance subsequent to acquisition without incurring high costs or obscuring information about the core government.

(c) Some consider that it is inappropriate to consolidate entities that have been rescued from financial distress because they do not represent core government activities and are not intended to be long-term investments.

(d) Where governments have high numbers of controlled entities the costs of the consolidation process are high and may be perceived to outweigh the benefits of consolidating those entities on a line by line basis.

BC12. Reflecting on these arguments for and against requiring consolidation of all controlled entities the IPSASB had regard to:

(a) The objectives of financial reporting, as outlined in *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (Conceptual Framework)*;

(b) The limited availability of evidence on user needs and usefulness of consolidated financial information (particularly on the usefulness of consolidated financial information in respect of specific types of controlled entities);

(c) The context within which whole of government consolidated financial statements are prepared;

(d) The interaction between the definition of control and the consolidation requirements in the proposed Standard; and

(e) The IPSASB's role as an international accounting standard setter.

BC13. With regard to the objectives of financial reporting, the IPSASB noted that Chapter 2 of the *Conceptual Framework* identifies the objectives of financial reporting as being to provide information that is useful for accountability purposes and for decision-making purposes. Because of the importance of the budget in the public sector (and the importance of demonstrating compliance with the budget) the IPSASB considered an argument that consolidated financial statements should consolidate only those entities that comprise a government's budget entity. However, the IPSASB agreed that a budget entity approach would not be appropriate for general purpose financial reporting because:

(a) Decisions about which entities are included in a government's budget may be based on factors other than the degree of autonomy of the entity and the extent to which it provides market goods or makes a commercial return.

(b) Decisions about which entities are included in a government's budget are often related to whether the entity's activity is intended to be self-funding. The exclusion of self-funding entities from a government's budget, essentially allows the offsetting of revenue and expenses for those activities and means that budget sector information does not reflect the substance of all transactions controlled by a government.

(c) The budget boundary for a jurisdiction is determined within a jurisdiction. If financial reporting were based on budget sectors there would not be standardized and comparable financial reporting by governments in an international context.

BC14. IPSAS 6 required the consolidation of all controlled entities apart from controlled entities where there was evidence that (a) control was intended to be temporary because the controlled entity was held exclusively with a view to its disposal within twelve months from acquisition and (b) management was actively seeking a buyer. Such temporarily controlled entities were required to be accounted for as financial instruments. The IPSASB considered whether this treatment of temporarily controlled entities should also be required in the proposed Standard. The IPSASB noted a number of concerns regarding the requirements in IPSAS 6. These included:

(a) The difficulty of identifying temporarily controlled entities;

(b) The difficulty of justifying a different accounting treatment for controlled entities that are held for more than a couple of years (which can occur with some entities that are initially considered to be temporarily controlled);

(c) The difficulty of disposing of an investment in its current form. A public sector entity may need to retain responsibility for certain risks in order to dispose of its investment in a temporarily controlled entity. Accounting for such entities as financial instruments provides only a partial representation of the risks associated with the investment;

(d) If a public sector entity is exposed to risks from an investment in a "temporarily" controlled entity, these risks should be reported consistently with the risk exposures from other controlled entities; and

(e) The provision of additional explanations by the reporting entity can address some of the issues that arise when large temporarily controlled entities are consolidated.

BC15. The IPSASB therefore decided not to require a different accounting treatment for temporarily controlled entities. Respondents to ED 49 generally agreed with this proposal, for similar reasons to the IPSASB. In discussing respondents' comments the IPSASB acknowledged the arguments made by those that considered there should be an exemption from consolidation for temporarily controlled entities, particularly those acquired by a government to protect the interests of citizens. However, the IPSASB also noted the experience of various jurisdictions in accounting for such situations and that consolidation of such entities had occurred in some jurisdictions. The IPSASB also considered the weight of the support for the removal of the exemption. Respondents noted that such investments can ultimately be held for longer periods than originally envisaged. Some respondents encouraged the IPSASB to consider requiring additional disclosures in respect of entities acquired with a view to disposal. The IPSASB agreed to require disclosure of interests in other entities held for sale in IPSAS 38, *Disclosure of Interests in Other Entities*.

BC16. In considering the existence of research regarding the usefulness of consolidated financial statements in meeting user needs, the IPSASB noted that although an increasing number of governments are applying the accrual basis of accounting, this has been a relatively recent trend and consolidation is often implemented in stages, with core government activities being consolidated first, followed by the consolidation of other categories of entities as time and resources permit. As a result, there are few jurisdictions that currently present consolidated whole of government financial statements, and empirical research on the usefulness of consolidated whole of government financial statements has been limited. Research to date has tended to focus on who uses consolidated financial statements and the overall benefits of consolidated financial statements, as opposed to the usefulness of consolidating certain types of controlled entities or accounting for them in an alternative way. As part of its deliberations the IPSASB did consider alternative ways of accounting for and presenting information on subsets of controlled entities such as temporarily controlled entities. The IPSASB noted the difficulties of consistently identifying categories of controlled entities that might be accounted for differently or subject to additional disclosures.

BC17. The IPSASB noted that in developing its requirements for investment entities the IASB focused on user needs. Matters considered by the IPSASB in relation to investment entities are discussed later in this Basis for Conclusions.

BC18. The IPSASB noted that many governments prepared statistical reports which present consolidated financial information in a sectoral approach, breaking down between the general government sectors and public corporation sectors (Non-Financial and Financial). This information is compiled in accordance with statistical guidance in the 2008 SNA, which, in turn, is consistent with guidance in the GFSM 2014 and the European System of Accounts (ESA 2010). The IPSASB considered whether such a statistical approach could be considered as an alternative to the compilation of whole of government accounts based on the IPSAS approach. The IPSASB noted that IPSAS 22, *Disclosure of Financial Information about the General Government Sector* provides guidance on the presentation of such statistical information in consolidated financial statements. However, IPSAS 22 neither requires the provision of such information in consolidated financial statements, nor permits the presentation of such information as an alternative to consolidation of all controlled entities. Although the IPSASB noted that statistical reporting serves an important role and provides information that is comparable across countries, the IPSASB agreed that such information had a different objective and did not fulfill the role of consolidated financial statements in giving an overview of all government activity. The IPSASB also noted that mandating the provision of statistical sector information by governments other than national governments could be difficult. The IPSASB therefore agreed that any changes to IPSAS 22 should not form part of its project to update IPSASs 6 to 8. Although the IPSASB decided not to provide guidance in this Standard on the presentation of information on statistical sectors, it noted that governments may present consolidated financial statements that are disaggregated by statistical sector.

BC19. ED 49 therefore proposed the consolidation of all controlled entities, other than the exception(s) from consolidation relating to investment entities (discussed separately in this Basis for Conclusions). The IPSASB sought the views of constituents as to whether there are any categories of entities that should not be consolidated, with any proposals for non-consolidation being justified having regard to user needs. Respondents were generally supportive of this proposal, although a number of respondents highlighted implementation difficulties (for example, the costs associated with consolidating a large number of controlled entities). Some respondents also commented on the existence of reporting entities established through legal or administrative means and noted that they may differ from the reporting entity identified in accordance with the proposed Standard. The IPSASB agreed to acknowledge, in the Standard, the existence of reporting entities established through legal or administrative means.

Investment Entities

BC20. In October 2012 the IASB issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27). As a result of these amendments IFRS 10 requires that a controlling entity that is an investment entity account for most of its investments at fair value through profit or loss, as opposed to consolidating them. The IPSASB considered the appropriateness of the requirements in IFRS 10 for similar entities in the public sector. The IPSASB first considered which entities might be affected by such requirements. Entities that might meet the definition of an investment entity include some sovereign wealth funds, some pension funds and some funds holding controlling interests in public-private partnership projects (PPP) or private finance initiatives (PFI). The IPSASB noted that any requirements applicable only to investment entities might apply to a relatively small number of public sector entities (having regard to the types of entities that might be investment entities and the fact that these entities might be required to report in accordance with a range of accounting standards, including domestic standards).

BC21. The IPSASB noted the comments made by respondents to the IASB in relation to the IASB's investment entity proposals and considered that similar arguments would apply in the public sector. Indeed, the IPSASB noted that some types of entities specifically identified by the IASB as potential investment entities (for example, sovereign wealth funds) could be public sector entities applying IPSASs. The IPSASB noted the IASB's focus on user needs in the IASB's deliberations on investment entities. The IPSASB noted that, depending on the reporting framework of the jurisdiction in which they operate, a public sector investment entity might be required to report in accordance with IPSASs, IFRSs, or domestic standards. The IPSASB agreed that the IFRS 10 requirement for an investment entity to account for its investments at fair value appeared to be appropriate in the public sector. The IPSASB also noted that consistent requirements in IPSASs and IFRSs would reduce any opportunity for accounting arbitrage when determining which accounting standards an investment entity should be required to apply.

BC22. The IPSASB considered whether the definition of an investment entity in IFRS 10 was appropriate in the public sector. The IPSASB agreed that the definition was largely appropriate although it noted that an investment entity will frequently have an external mandate that establishes its purpose (as opposed to the entity asserting its purpose to investors) and amended the definition accordingly. The IPSASB considered that it would be helpful to give additional public sector examples of scenarios in which an entity would not be an investment entity by virtue of having additional objectives.

BC23. The IPSASB considered whether the typical characteristics of an investment entity were appropriate for application in the public sector. The IPSASB noted that IFRS 10 allows for the possibility that an entity may be an investment entity, despite not meeting all the typical characteristics. In such cases the entity is required to explain why it is an investment entity, despite not having all of the typical characteristics of an investment entity. The IPSASB considered that the typical characteristics identified in IFRS 10 were not likely to be typical characteristics in the public sector context. For example, a sovereign wealth fund might:

(a) Have a single investor (being a Minister or a public sector entity). The fund could argue that it is investing funds on behalf of, or for the benefit of, citizens. IFRS 10, paragraph BC259, explicitly refers to government-owned investment funds and funds wholly owned by pension plans and endowments when explaining why the IASB decided to make this a typical characteristic rather than an essential part of the definition of an investment entity.

(b) Have investors that are related parties. A fund with a related party investor could nevertheless be acting on behalf of many unrelated beneficiary investors.

(c) Have ownership interests in a form other than equity or similar interests. The IPSASB noted both that the form of ownership interests in sovereign wealth funds could vary, and that IFRS 10, paragraph BC264, specifically refers to pension funds and sovereign wealth funds when explaining why the IASB decided to make this a typical characteristic rather than an essential part of the definition. IFRS 10, paragraph BC264, states "For example, a pension fund or sovereign wealth fund with a single direct investor may have beneficiaries that are entitled to the net assets of the investment fund, but do not have ownership units.

BC24. Because of the differences between the private and public sector, the IPSASB decided not to identify typical characteristics separately from the definition of an investment entity. The IPSASB noted that much of the discussion in IFRS 10 regarding the typical characteristics of investment entities described ways in which an entity could demonstrate that it met the definition of an investment entity. The IPSASB therefore decided to retain such guidance, but to locate it together with other guidance on the definition of an investment entity. The IPSASB agreed that the characteristic in IFRS 10 that "The individuals or entities that have provided funds to the entity are not related parties of the entity" did not reflect the public sector context and agreed to omit the guidance on that characteristic.

BC25. Although the IPSASB decided not to identify typical characteristics separately from the definition of an investment entity, the IPSASB considered that most public sector entities classifying themselves as investment entities should be required to disclose information about the judgments and assumptions made. The IPSASB considered that disclosure of these judgments and assumptions would be important for transparency and encourage appropriate use of the investment entity accounting requirements.

BC26. The IPSASB noted that in comparison with private sector entities which tend to have clear financial objectives, public sector entities can have a broader range of objectives, and these objectives can change over time. A public sector entity's objectives may also change as a result of changes in government policy and changes could lead to an entity that had formerly met the definition of an investment entity ceasing to do so. Having regard to the possibility of changing objectives the IPSASB therefore agreed to highlight the need for an entity to reassess its status on a regular basis.

BC27. The IPSASB noted that the IFRS 10 investment entity requirements apply to the financial statements of an investment entity itself – they cannot be applied by the controlling entity of any investment entity. IFRS 10 requires that a controlling entity that is not itself an investment entity shall present consolidated financial statements in which all controlled entities are consolidated on a line by line basis. The IPSASB considered whether the public sector context would lead it to place more or less weight on arguments considered by the IASB in relation to this matter, and whether there were any public sector characteristics that would support a differing accounting treatment by the controlling entity of an investment entity.

BC28. The IPSASB noted that the IASB had concerns that if a non-investment controlling entity were required to retain the fair value treatment used by its controlled investment entities, it could achieve different accounting outcomes by holding controlled entities directly or indirectly through a controlled investment entity. The IPSASB considered that this issue was of less concern in the public sector context. In particular the IPSASB noted that ownership interests through shares or other equity instruments are less common in the public sector. As a consequence, it is less likely that entities within an economic entity in the public sector would hold an ownership investment in the ultimate controlling entity and less likely that they would have ownership investments in other entities within the economic entity.

BC29. The IPSASB considered what type of information users would find most useful about a controlled investment entity. The IPSASB considered that users would find it most useful if the accounting for investments applied in a controlled investment entity's financial statements were extended to its controlling entity's financial statements. The IPSASB therefore proposed that a controlling entity with a controlled investment entity should be required to present consolidated financial statements in which it (i) measures the investments of the controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 41 and (ii) consolidates the other assets and liabilities and revenue and expenses of the controlled investment entity in accordance with the usual consolidation accounting policies required by the Standard. The IPSASB considered that its proposals reflect the fact that a controlling entity does not manage an investment entity itself on a fair value basis. Rather, it manages the investments of the investment entity on a fair value basis. This approach is also consistent with the accounting by an investment entity for its investments in other entities.

BC30. At the time that IPSAS 35 was being developed the IASB proposed to clarify aspects of the application of the investment entity requirements. The IASB issued *Investment Entities: Applying the Consolidation Exception* (Amendments to IFRS 10, IFRS 12 and IAS 28) in December 2014. The IPSASB considered that these clarifications were helpful in addressing implementation issues identified by early adopters of the IASB's investment entity requirements and incorporated those aspects of the amendments that were relevant to this Standard.

Control (paragraphs 18–37)

BC31. The IPSASB agreed that the three requirements for control outlined in IFRS 10 are generally appropriate for the public sector. The IPSASB noted that the IFRS 10 requirements to have power, returns and a link between power and returns is similar to the approach previously taken by the IPSASB in IPSAS 6, although IPSAS 6 required that both power and benefits be present. Consistent with the terminology used in IPSAS 6 the IPSASB decided that the term "benefits" was generally more appropriate than "returns" in the public sector context (as discussed under the subheading "Terminology" below). However, the term "returns" continued to be used in the context of investment entities.

BC32. The IPSASB took note of the approach taken in Government Finance Statistics in relation to control over an entity. The 2008 SNA, paragraph 4.80, includes eight indicators of control of corporations and five indicators of control of nonprofit institutions and explains that "Although a single indicator could be sufficient to establish control, in other cases a number of indicators may collectively indicate control". Overall, the direction of the statistical indicators is on the same lines as the approach in this Standard and therefore the practical results of the respective analyses will likely largely coincide. Some of the indicators in GFS are mentioned in the following paragraphs.

Power (paragraphs 23–29)

BC33. The IPSASB decided to modify IFRS 10 to:

(a) Highlight the range of relevant activities that could occur in the public sector and stress that control of financial and operating policies can demonstrate power over relevant activities;

(b) Clarify that regulatory control and economic dependence do not give rise to power for the purposes of the Standard; and

(c) Discuss specific powers that could give rise to control in the public sector, including golden shares, a right to appoint the majority of the board of another entity, and powers obtained through legislation or enabling documents.

Regulatory Control

BC34. The IPSASB agreed that the previous guidance on regulatory control in IPSAS 6 should be incorporated in the Standard. The IPSASB noted that IFRS 10 had been developed for application by profit-oriented entities, few of whom have powers to create or enforce legislation or regulations. By contrast, the nature of government means that regulatory power occurs frequently in the public sector.

BC35. In considering how to incorporate guidance on regulatory control in the Standard the IPSASB noted that (i) the discussion of power in IFRS 10 focuses on the ability to influence the "relevant activities" of the investee, and (ii) power is only one of the three elements that are required for control to exist. The IPSASB decided to place the discussion of regulatory control alongside the discussion of power and relevant activities.

BC36. The IPSASB noted that the discussion of regulation and control in the 2008 SNA is similar to that previously in IPSAS 6. The 2008 SNA states:

> **Regulation and control**. The borderline between regulation that applies to all entities within a class or industry group and the control of an individual corporation can be difficult to judge. There are many examples of government involvement through regulation, particularly in areas such as monopolies and privatized utilities. It is possible for regulatory involvement to exist in important areas, such as in price setting, without the entity ceding control of its general corporate policy. Choosing to enter into or continue to operate in a highly regulated environment suggests that the entity is not subject to control. When regulation is so tight as to effectively dictate how the entity performs its business, then it could be a form of control. If an entity retains unilateral discretion as to whether it will take funding from, interact commercially with, or otherwise deal with a public sector entity, the entity has the ultimate ability to determine its own corporate policy and is not controlled by the public sector entity.

BC37. The IPSASB noted that the 2008 SNA discusses control by a dominant customer. It states:

> "In general, if there is clear evidence that the corporation could not choose to deal with non-public sector clients because of public sector influence, then public control is implied."

Economic Dependence

BC38. IFRS 10 paragraph B40 states that "…in the absence of any other rights, economic dependence of an investee on the investor (such as relations of a supplier with its main customer) does not lead to the investor having power over the investee." Although the IPSASB agreed that economic dependence, on its own, does not give rise to control, the IPSASB noted that, in the public sector, economic dependence may occur in conjunction with other rights. These other rights need to be assessed to determine if they give rise to control.

BC39. Because of the prevalence of economic dependence in the public sector the IPSASB decided that it was appropriate to discuss ways in which economic dependence can arise and include examples of economic dependence.

Special Voting Rights Attaching to Ownership Interests (Golden Shares)

BC40. The IPSASB agreed that the Standard should acknowledge that special voting rights attaching to ownership interests (often referred to as "golden shares") will influence assessments of control. The IPSASB noted that such rights are also acknowledged in the GFSM 2014.

Substantive Rights

BC41. Statutory independence is common in the public sector. The IPSASB agreed to illustrate the ways in which statutory independence may influence an investor's assessments of rights. The Standard notes that the existence of statutory independence of an investee could be seen as a barrier to the investor exercising its rights (paragraph AG26). It also notes that the existence of statutory powers to operate independently does not, of itself, preclude an entity from being controlled by another entity (paragraph 25).

Terminology

BC42. In addition to making changes to reflect the standard terminology in IPSASs, the IPSASB agreed that a number of other changes to the terminology in IFRS 10 were appropriate. Unless noted otherwise in an IPSAS, this discussion of terminology is relevant to IPSASs 34 to 38.

Investor/Investee

BC43. IFRS 10 uses the terms "investor" and "investee" to denote (i) the potential controlling entity, being the entity that is applying the Standard to assess whether control exists and (ii) the potential controlled entity. The IPSASB considered that these terms were inappropriate in most parts of this Standard because they could be read as implying the existence of a financial instrument representing an ownership interest. Most assessments of control in the public sector do not involve such financial instruments.

BC44. The IPSASB considered other terms that could be used to describe investors and investees, in the context of the Standard. One option was to refer to an investor as a "potential controlling entity" and an investee as a "potential controlled entity". The IPSASB considered that these phrases, whilst clear in meaning, would be cumbersome to use throughout the Standard. The IPSASB noted that IPSASs generally refer to the entity applying the Standard as "the entity". In the case of this Standard, the entity applying the Standard is the entity that is assessing whether or not it controls another entity (referred to as the investor in IFRS 10). The entity applying the Standard is doing so in order to determine whether it controls another entity. The IPSASB therefore decided that, depending on the context, it would refer to the investor as "the entity" and the investee as "another entity", "other entity", or "entity being assessed for control".

BC45. The IPSASB agreed to retain use of the term "investors" where the Standard is referring to a specific investment and the term is used in accordance with its usual meaning. This was particularly relevant in the parts of the Standard dealing with investment entities.

BC46. The IPSASB also agreed that the terms "investor" and "investee" are appropriate when referring to interests in joint ventures and associates.

Binding Arrangements

BC47. The IPSASB agreed to replace most references to "contractual arrangements" in IFRS 10 with references to the term "binding arrangements". This change acknowledges that in some jurisdictions, entities applying IPSASs may not have the power to enter into contracts but nevertheless may have the authority to enter into binding arrangements. In addition, the IPSASB agreed that binding arrangements, for the purpose of this Standard, should encompass rights that arise from legislative or executive authority. The definition of binding arrangements used in this Standard is intentionally broader than that used in the financial instruments standards, where it is used in relation to rights that are similar to contracts and in respect of willing parties.

Benefits

BC48. The IPSASB agreed that the term "benefits" is more appropriate than the term "returns" in the public sector, particularly given the existence of control relationships in the absence of a financial investment in the controlled entity. The IPSASB considered that the term "returns" could be regarded as giving an inappropriate emphasis to financial returns, whereas, in the public sector, benefits are more likely to be non-financial than financial. The term "returns" was retained in the context of investment entities.

BC49. The IPSASB decided to modify IFRS 10 to:

(a) Highlight that many assessments of control in the public sector involve assessments of non-financial benefits;

(b) Note that benefits can have positive or negative aspects; and

(c) Include examples of benefits in a public sector context.

BC50. The IPSASB agreed to locate the examples of benefits in the body of the Standard as it considered that the examples would be particularly useful for an entity making an initial assessment of whether it might control other entities.

BC51. The definition of control in IPSAS 35 refers to "variable benefits" and this concept is referred to throughout the Standard. The IPSASB considered how the Standard would apply to benefits that appeared to be fixed or constant. The IPSASB noted that the IASB had explicitly considered this issue and had provided examples to show that benefits that appear to be fixed could in fact be variable, because they exposed the entity to performance risk. The IPSASB noted that the IASB examples related to financial benefits and agreed to incorporate an example of a non-financial benefit in paragraph AG58.

Uniform Reporting Dates

BC52. The IPSASB considered whether to impose a time limit on the difference between the end of the reporting period of the controlling entity and its controlled entities. The IPSASB noted that IFRS 10 requires that the financial statements used in preparing consolidated financial statements have the same reporting date, or where this is impracticable, requires that adjustments be made to the most recent financial statements of the controlled entities. In addition, IFRS 10 limits the difference in dates to three months. The IPSASB noted that there may be instances in the public sector where entities have different reporting dates and it may not be possible to change those dates. The IPSASB agreed not to impose a three month limit on the difference in dates.

Implementation Issues

BC53. A number of respondents commented on the difficulty of preparing consolidated financial statements, particularly when there are a large number of controlled entities, as in the case of whole of government financial statements. The IPSASB acknowledged these practical difficulties, whilst noting that most jurisdictions presenting consolidated financial statements have faced similar difficulties. In these jurisdictions the consolidating entities used simplifying strategies to cope with the complexity and the consolidation difficulties. Such strategies include:

(a) Assessing the existence of control for various categories of entities in phases, with an initial focus on entities that are likely to be material.

(b) Not consolidating (or deferring the consolidation of) controlled entities that are likely to be immaterial.

(c) Identifying the cost-effective ways of obtaining information about inter-entity balances and transactions.

(d) Not eliminating immaterial inter-entity transactions and balances.

(e) Considering whether all disclosures must be made in respect of all entities.

BC54. The IPSASB considered whether to provide specific guidance on the application of materiality when preparing consolidated financial statements but concluded that this would not be appropriate in a financial reporting standard.

Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

BC55. At the time that IPSAS 35 was being developed, the IASB was in the process of seeking feedback on proposals to amend IFRS 10 and IAS 28 so that the requirements for the recognition of a partial gain or loss for transactions between an investor and its associate or joint venture would apply only to the gain or loss resulting from the sale or contribution of assets *that do not constitute a business*, as defined in IFRS 3, *Business Combinations*. The IASB issued *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28) in September 2014. The IPSASB agreed not to incorporate the requirements introduced by these amendments in IPSAS 35 and IPSAS 36, *Investments in Associates and Joint Ventures,* on the grounds that it would be more appropriate to consider the recognition of full or partial gains and losses in the context of drafting standards-level requirements for public sector combinations.

BC56. At the time the IPSASB developed ED 60, *Public Sector Combinations*, it reconsidered whether to include guidance on how to account for the loss of control of a former controlled entity to an investor's associate or joint venture. The IPSASB reviewed the guidance issued by the IASB in *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28). The effect of the IASB's amendments if adopted in IPSAS 35 would be that a partial gain or loss for transactions between an investor and its associate or joint venture would apply only to the gain or loss resulting from the loss of control of a former controlled entity *that does not contain an operation*. The IPSASB did not identify any public sector reason to depart from the IASB's approach. Consequently, the IPSASB agreed to include this guidance (amended to fit the terminology and definitions in ED 60) in IPSAS 35.

BC57. In December 2015, the IASB deferred the implementation of the guidance in *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28). This was because the IASB was undertaking further research in this area as part of its project on equity accounting, and it did not want to require entities to change their accounting twice in a short period. In deferring the effective date, the IASB continued to allow early application of the guidance as it did not wish to prohibit the application of better financial reporting. The IPSASB reviewed the decision of the IASB to defer the implementation of this guidance. The IPSASB did not identify any public sector reason to depart from the IASB's approach. Consequently, the IPSASB agreed to include this guidance (amended to fit the terminology and definitions in IPSAS 40) in IPSAS 35, to be applied from a date to be determined by the IPSASB.

Revision of IPSAS 35 as a result of the IPSASB's *The Applicability of IPSASs*, issued in April 2016

BC58. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:

(a) Removes the standard paragraphs about the applicability of IPSASs to "public sector entities other than GBEs" from the scope section of each Standard;

(b) Replaces the term "GBE" with the term "commercial public sector entities", where appropriate; and

(c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.

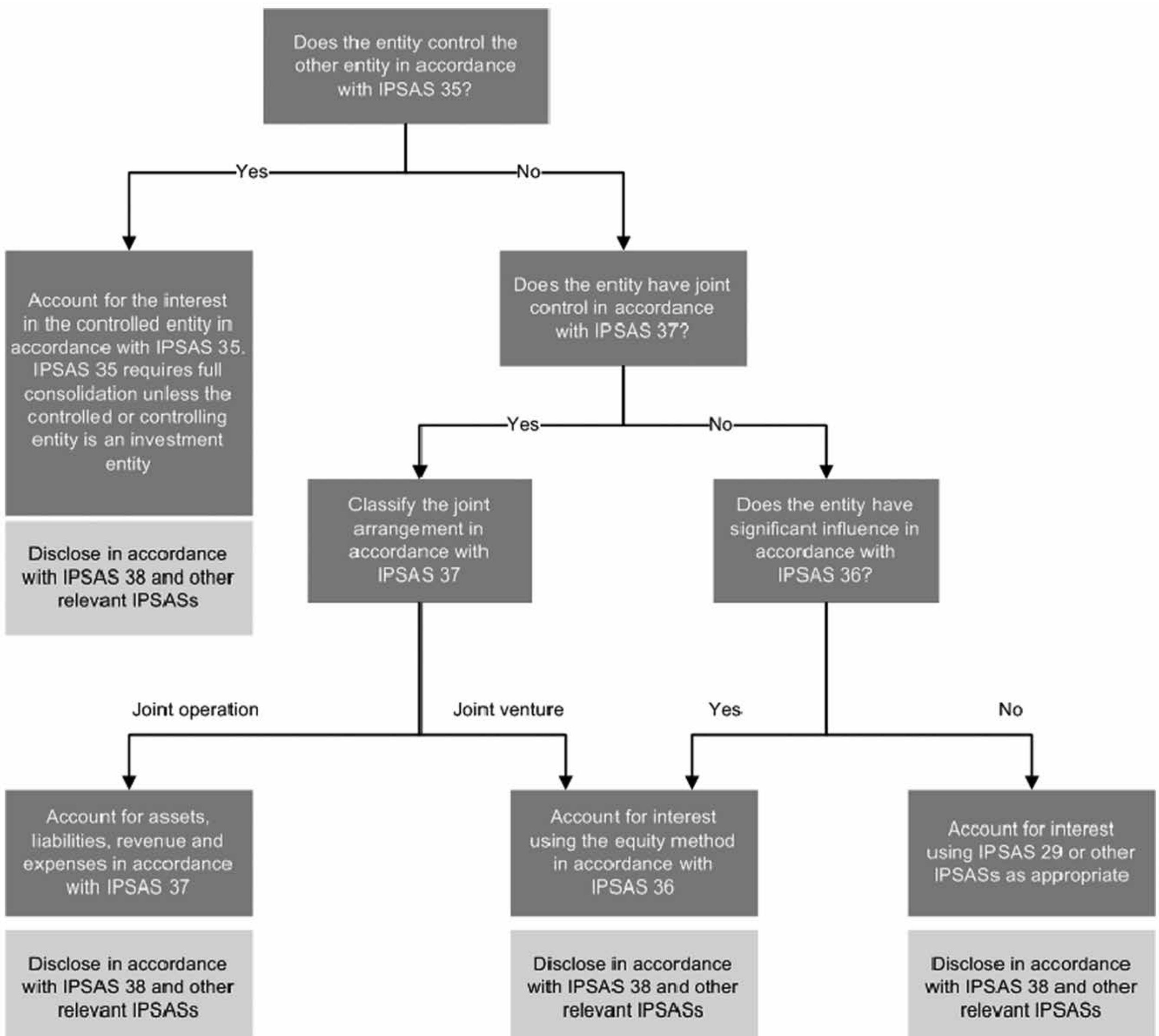
Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 35.

Nature of Relationship with Another Entity

IG1. The diagram below summarizes the accounting for various types of involvement with another entity.

Flowchart 1: Forms of Involvement with Other Parties



Illustrative Examples

These examples accompany, but are not part of, IPSAS 35.

IE1. The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying IPSAS 35.

Power (paragraphs AG9–AG56)

IE2. The following example illustrates an assessment of whether power exists for the purposes of this Standard.

Example 1

A state government partially funds the activities of a local government. Some of this funding is required to be spent on specified activities. The local government has a council that is elected every four years by the local community. The council decides how to use the local government's resources for the benefit of the local community. The activities of the local government are diverse and include library services, provision of leisure facilities, management of refuse and wastewater, and enforcement of building and health and safety regulations. These activities are the relevant activities of the local government. Many of these activities also coincide with the interests of the state government.

Despite its partial funding of the local government's activities, the state government does not have the power to direct the relevant activities of the local government. The rights of the local government over the relevant activities preclude the state government from having control.

Regulatory Control (paragraph AG12)

IE3. The following examples illustrate various forms of regulatory control. None of these forms of regulatory control give rise to power over the relevant activities for the purposes of this Standard. However, those examples do not rule out that there may be instances where power over the relevant activities for the purposes of this Standard may derive from regulatory control.

Example 2

A pollution control authority has the power to close down the operations of entities that are not complying with environmental regulations.

The existence of this power does not constitute power over the relevant activities.

Example 3

A city has the power to pass zoning laws to limit the location of fast food outlets or to ban them altogether.

The existence of this power does not constitute power over the relevant activities of the fast food outlets.

Example 4

A central government has the power to impose regulatory control on monopolies. A wholly owned government agency has the power to regulate monopolies that are subject to such regulatory control and has established price ceilings for entities that distribute electricity. The central government does not have an ownership interest in the electricity distributors and does not receive financial benefits from the electricity distributors. Neither the central government, nor the government agency, has control as a result of the power to impose regulatory control. Any other powers would need to be separately assessed.

Example 5

A gaming control board (GCB) is a government agency that regulates casinos and other types of gaming in a state, and enforces state gaming legislation. The GCB is responsible for promulgating rules and regulations that govern the conduct of gaming activities in the state. The rules and regulations stem from legislation. The legislation was passed by the legislature and sets forth the broad policy of the state with regard to gaming; while the rules and regulations provide detailed requirements that must be satisfied by a gaming establishment, its owners, employees, and vendors. The rules and regulations cover a broad range of activity, including licensing, accounting systems, rules of casino games, and auditing.

The GCB also has authority to grant or deny licenses to gaming establishments, their ownership, employees, and vendors. In order to obtain a license, an applicant must demonstrate that they possess good character, honesty and integrity. License application forms typically require detailed personal information. Based upon the type of license being sought, an applicant may also be required to disclose details regarding previous business relationships, employment history, criminal records, and financial stability.

Although the rules and regulations have an impact on how gaming establishments operate, the GCB does not have power over the relevant activities (as defined in this Standard) of the gaming establishments. The regulations apply to all gaming establishments and each establishment has a choice as to whether it wishes to engage in gaming or not. The purpose of the gaming legislation and regulations is to protect the public, rather than to establish a controlling interest in the gaming establishments.

Relevant Activities and Direction of Relevant Activities (paragraphs AG13–AG15)

IE4. The following examples illustrate assessments of whether an entity has the power to direct the relevant activities of another entity for the purposes of this Standard.

Example 6

Entities A and B, form another entity, entity C, to develop and market a medical product. Entity A is responsible for developing and obtaining regulatory approval of the medical product—that responsibility includes having the unilateral ability to make all decisions relating to the development of the product and to obtaining regulatory approval. Once the regulator has approved the product, entity B will manufacture and market it—entity B has the unilateral ability to make all decisions about the manufacture and marketing of the product. If all the activities—developing and obtaining regulatory approval as well as manufacturing and marketing of the medical product—are relevant activities, entity A and entity B each needs to determine whether they are able to direct the activities that most significantly affect the benefits from entity C. Accordingly, entity A and B each need to consider whether developing and obtaining regulatory approval or the manufacturing and marketing of the medical product is the activity that most significantly affects the benefits from entity C and whether they are able to direct that activity. In determining which entity has power, entities A and B would consider:

(a) The purpose and design of entity C;

(b) The factors that determine the surplus, revenue and value of entity C as well as the value of the medical product;

(c) The effect of their decision-making authority on entity C’s performance with respect to the factors in (b); and

(d) Their exposure to variability of benefits from entity C.

In this particular example, the entities would also consider:

(a) The uncertainty of, and effort required in, obtaining regulatory approval (considering their record of successfully developing and obtaining regulatory approval of medical products); and

(b) Which entity controls the medical product once the development phase is successful.

Example 7

An investment vehicle is created and financed with a debt instrument held by an entity (the debt investor) and equity instruments held by a number of other investors. The equity tranche is designed to absorb the first losses and to receive any residual benefit from the investment vehicle. One of the equity investors who holds 30 per cent of the equity instruments is also the asset manager. The investment vehicle uses its proceeds to purchase a portfolio of financial assets, exposing the investment vehicle to the credit risk associated with the possible default of principal and interest payments of the assets. The transaction is marketed to the debt investor as an investment with minimal exposure to the credit risk associated with the possible default of the assets in the portfolio because of the nature of these assets and because the equity tranche is designed to absorb the first losses of the investment vehicle. The benefits from the investment vehicle are significantly affected by the management of the investment vehicle's asset portfolio, which includes decisions about the selection, acquisition and disposal of the assets within portfolio guidelines and the management upon default of any portfolio assets. All those activities are managed by the asset manager until defaults reach a specified proportion of the portfolio value (i.e., when the value of the portfolio is such that the equity tranche of the investment vehicle has been consumed). From that time, a third-party trustee manages the assets according to the instructions of the debt investor. Managing the investment vehicle's asset portfolio is the relevant activity of the investment vehicle. The asset manager has the ability to direct the relevant activities until defaulted assets reach the specified proportion of the portfolio value; the debt investor has the ability to direct the relevant activities when the value of defaulted assets surpasses that specified proportion of the portfolio value. The asset manager and the debt investor each need to determine whether they are able to direct the activities that most significantly affect the benefits from the investment vehicle, including considering the purpose and design of the investment vehicle as well as each party's exposure to variability of benefits.

Rights that Give an Entity Power over another Entity (paragraphs AG16–AG28)

IE5. The following examples illustrate assessments of whether an entity has the power to direct the relevant activities of another entity for the purposes of this Standard.

Example 8

A government housing agency establishes a community housing program that provides low-cost housing. The program is operated under an agreement with an incorporated association. The association's only activity is to manage the community housing facility. The association has no ownership instruments.

The relevant activities of the association comprise:

- Reviewing and selecting applicants for housing;
- The day-to-day operation of the housing program;
- Maintaining the houses and common facilities; and
- Improving and extending the housing facilities.

The board of governors of the association has 16 members, with eight appointed by (and subject to removal by) the government housing agency. The chair is appointed by the board from amongst the appointees of the government housing agency, and has a casting vote that is rarely exercised. The board meets regularly and reviews reports received from the association's management. Based on these reports, the board may confirm or override management decisions. In addition, the board makes decisions on major issues such as significant maintenance and investing further capital to build additional housing, after reviewing vacancy levels and the demand for housing.

The government housing agency owns the land on which the housing facilities stand and has contributed capital and operating funds to the association since it was established. The association owns the housing facilities.

The association retains any surplus resulting from the operation of the facilities and under its constitution is unable to provide a direct financial return to the government housing agency. The above fact pattern applies to examples 8A and 8B described below. Each example is considered in isolation.

Example 8A

Based on the facts and circumstances outlined above, the government housing agency controls the association.

The government housing agency has rights that give it the current ability to direct the relevant activities of the association, regardless of whether it chooses to exercise those rights.

The government housing agency appoints eight members of the board of governors, one of whom will become the chair, who has a casting vote. As a result, the government housing agency has power over the association through substantive rights that give it the current ability to direct the relevant activities of the association, regardless of whether the government housing agency chooses to exercise those substantive rights.

The government housing agency also has exposure or rights to variable benefits from its involvement with the association. The government housing agency obtains non-financial benefits through the association furthering its social objective of meeting the need for low-cost community housing. Although not able to receive direct financial benefits, the government housing agency obtains indirect benefits through its ability to direct how the financial returns are to be employed in the community housing program.

The government housing agency also satisfies the final control criterion. Through its appointees on the board, the government housing agency has the ability to use its power to affect the nature or amount of its benefits from the association.

The government housing agency satisfies all three criteria for control and therefore the government housing agency controls the association.

Example 8B

In this example, the facts of Example 8A apply, except that:

(a) The association's board of governors is elected through a public nomination and voting process that does not give rights to the government housing agency to appoint board members; and

(b) Decisions made by the association's board are reviewed by the government housing agency, which may offer advice to the association.

Based on the revised facts and circumstances outlined above, the government housing agency does not have substantive rights relating to the association and therefore does not have power over the association.

The government housing agency's social objectives in relation to low-cost community housing are still being achieved and therefore it will still obtain direct non-financial benefits. However, congruence of objectives alone is insufficient to conclude that one entity controls another entity (refer paragraph 36).

The government housing agency does not have power and consequently does not have the ability to use power to affect the nature or amount of the agency's benefits. The government housing agency is unable to satisfy two of the three control criteria and therefore the government housing agency does not control the association.

Example 9

A government has the right to appoint and remove the majority of members of a statutory body. This power has been used by previous governments. The current government has not done so because it does not wish, for political reasons, to be regarded as interfering in the activities of the statutory body. In this case the government still has substantive rights, even though it has chosen not to use them.

Example 10

A local government has a policy that, where it holds land that is surplus to its requirements, consideration should be given to making the land available for affordable housing. The local government establishes terms and conditions to ensure that the housing provided remains affordable and available to meet local housing needs.

In accordance with this policy, the local government sold part of a site to a housing association for CU1 to provide 20 affordable homes. The remainder of the site was sold at open market value to a private developer.

The contract between the local government and the housing association specifies what the land can be used for, the quality of housing developments, ongoing reporting and performance management requirements, the process for return of unused land and dispute resolution. The land must be used in a manner consistent with the local government's policy for affordable housing.

The agreement also has requirements regarding the housing association's quality assurance and financial management processes. The housing association must demonstrate that it has the capacity and authority to undertake the development. It must also demonstrate the added value that can be achieved by joining the local government's resources with that of the housing association to address a need within a particular client group in a sustainable way.

The Board of the housing association is appointed by the members of the housing association. The local government does not have a representative on the Board.

Based on the facts and circumstances outlined above, the government housing agency does not hold sufficient power over the association to direct its relevant activities and therefore does not control the association. The local government may receive indirect, non-financial benefits from the association in that the local government's social objectives in relation to low-cost community housing are being furthered by the activities of the housing association. However, congruence of objectives alone is insufficient to conclude that one entity controls another (see paragraph 36). In order to have power over the housing association the local government would need to have the ability to direct the housing association to work with the local government to further the local governments' objectives.

Example 11

An entity being assessed for control has annual shareholder meetings at which decisions to direct the relevant activities are made. The next scheduled shareholders' meeting is in eight months. However, shareholders that individually or collectively hold at least 5 per cent of the voting rights can call a special meeting to change the existing policies over the relevant activities, but a requirement to give notice to the other shareholders means that such a meeting cannot be held for at least 30 days. Policies over the relevant activities can be changed only at special or scheduled shareholders' meetings. This includes the approval of material sales of assets as well as the making or disposing of significant investments.

The above fact pattern applies to examples 11A–11D described below. Each example is considered in isolation.

Example 11A

An entity holds a majority of the voting rights in the other entity. The entity's voting rights are substantive because the entity is able to make decisions about the direction of the relevant activities when they need to be made. The fact that it takes 30 days before the entity can exercise its voting rights does not stop the entity from having the current ability to direct the relevant activities from the moment the entity acquires the shareholding.

Example 11B

An entity is party to a forward contract to acquire the majority of shares in the other entity. The forward contract's settlement date is in 25 days. The existing shareholders are unable to change the existing policies over the relevant activities because a special meeting cannot be held for at least 30 days, at which point the forward contract will have been settled. Thus, the entity has rights that are essentially equivalent to the majority shareholder in example 11A above (i.e., the entity holding the forward contract can make decisions about the direction of the relevant activities when they need to be made). The entity's forward contract is a substantive right that gives the entity the current ability to direct the relevant activities even before the forward contract is settled.

Example 11C

An entity holds a substantive option to acquire the majority of shares in the other entity that is exercisable in 25 days and is deeply in the money. The same conclusion would be reached as in example 11B.

Example 11D

An entity is party to a forward contract to acquire the majority of shares in the other entity, with no other related rights over the other entity. The forward contract's settlement date is in six months. In contrast to the examples above, the entity does not have the current ability to direct the relevant activities. The existing shareholders have the current ability to direct the relevant activities because they can change the existing policies over the relevant activities before the forward contract is settled.

Power without a Majority of the Voting Rights and Special Voting Rights Attaching to Ownership Interests (paragraphs AG36–AG37)

IE6. The following examples illustrate assessments of whether special voting rights attaching to ownership interests in another entity give rise to power for the purposes of this Standard.

Example 12

A central government has privatized a company and, in order to protect its national interests, it has used a "golden share" mechanism. The "golden share" does not have any value or give any percentage rights to the capital of the company. The golden share states that control of the company, or a 24 percent stake in the company cannot be sold without the permission of the central government.

The central government has protective rights, not substantive rights.

Example 13

A central government sold all of its shares in a company, but kept a golden share (with a nominal value of one currency unit). The golden share granted the Secretary of State (as the holder of the share) a 15 percent shareholding in the company, and consequently the ability to block any potential takeover of the business. It also required that the chairman of the board and the chief executive be citizens of the country. The rationale for the golden share was to protect the company from an overseas acquisition, principally on the grounds of national security.

The central government has protective rights, not substantive rights.

Example 14

A central government does not own any shares in defense companies. However it has passed legislation which specifies that, with respect to companies carrying out strategic activities for the defense and national security system, in the event that fundamental interests of national defense or security could be materially affected, the government may:

(a) Impose specific conditions on the purchase of an interest in any such company – by any person – relating to the security of procurement and of information, the transfer of technologies and export controls;

(b) Veto the purchase by any person – other than the state (whether directly or indirectly, individually or jointly) – of an interest in the voting share capital in any such company that, given its size, may jeopardize defense or national security; and

(c) Veto the adoption of resolutions by the shareholders or the board of directors of any such company relating to certain extraordinary transactions (such as mergers, de-mergers, assets disposals, winding up, and bylaws amendments concerning the corporate purpose or equity ownership caps in certain state-controlled companies).

The central government has protective rights, not substantive rights, in respect of these companies.

Control of the Board or Other Governing Body (paragraph AG38)

IE7. The following example illustrates assessments of whether an entity has control of the board or governing body of another entity for the purposes of this Standard. The existence of such control may provide evidence that an entity has sufficient rights to have power over another entity.

Example 15

A national museum is governed by a board of trustees who are chosen by the government department responsible for funding the museum. The trustees have freedom to make decisions about the operation of the museum.

The department has the power to appoint the majority of the museum's trustees. The department has the potential to exercise power over the museum.

Economic Dependence (paragraphs AG41–AG42)

IE8. The following examples illustrate assessments of whether dependence on funding from another entity gives rise to power in the context of this Standard.

Example 16

A research institution is one of many institutions that receive the majority of their funding from a central government. The institutions submit proposals and the funding is allocated through a tendering process. The research institution retains the right to accept or decline funding.

The central government does not control the research institution because the research institution can choose to decline funding from the government, seek alternative sources of funding or cease to operate.

Example 17

A catering entity has a binding arrangement to supply food to a government-owned school. The arrangement is between the company and the school. The school contracts generate the majority of the revenue of the catering entity. There are general requirements, set out in regulations, which are applicable to all such arrangements including nutritional standards and policies on procurement. For example, the arrangements specify how much produce must be purchased locally.

Current arrangements are for a period of five years. At the end of this period, if the catering entity wishes to continue supplying school meals it is required to go through a tendering process and compete with other entities for the business.

The school does not control the catering entity because the catering entity can choose to stop supplying school meals, seek other work, or cease to operate.

Example 18

An international donor funds a project in a developing country. The donor uses a small, local agency in the country to run the project. The local agency has its own management board but is highly dependent on the donor for funding. The agency retains the power to turn down funding from the donor.

The international donor does not control the local agency because the agency can choose not to accept funding from the donor and seek alternative sources of funding, or cease to operate.

Voting Rights (paragraphs AG43–AG48)

IE9. The following examples illustrate assessments of whether an entity with less than a majority of the voting rights in another entity has the practical ability to direct the relevant activities unilaterally, and whether its rights are sufficient to give it power over that other entity for the purposes of this Standard.

Example 19

An entity acquires 48 per cent of the voting rights of another entity. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders have any arrangements to consult any of the others or make collective decisions. When assessing the proportion of voting rights to acquire, on the basis of the relative size of the other shareholdings, the entity determined that a 48 per cent interest would be sufficient to give it control. In this case, on the basis of the absolute size of its holding and the relative size of the other shareholdings, the entity concludes that it has a sufficiently dominant voting interest to meet the power criterion without the need to consider any other evidence of power.

Example 20

Entity A holds 40 per cent of the voting rights of another entity and twelve other investors each hold 5 per cent of the voting rights of the other entity. A shareholder agreement grants Entity A the right to appoint, remove and set the remuneration of management responsible for directing the relevant activities. To change the agreement, a two-thirds majority vote of the shareholders is required. In this case, Entity A concludes that the absolute size of its holding and the relative size of the other shareholdings alone are not conclusive in determining whether it has rights sufficient to give it power. However, Entity A determines that its contractual right to appoint, remove and set the remuneration of management is sufficient to conclude that it has power over the other entity. The fact that Entity A might not have exercised this right or the likelihood of Entity A exercising its right to select, appoint or remove management shall not be considered when assessing whether Entity A has power.

Example 21

Entity A holds 45 per cent of the voting rights of another entity. Two other investors each hold 26 per cent of the voting rights of the other entity. The remaining voting rights are held by three other shareholders, each holding 1 per cent. There are no other arrangements that affect decision-making. In this case, the size of Entity A's voting interest and its size relative to the other shareholdings are sufficient to conclude that Entity A does not have power. Only two other investors would need to co-operate to be able to prevent Entity A from directing the relevant activities of the other entity.

Example 22

An entity holds 35 per cent of the voting rights of another entity. Three other shareholders each hold 5 per cent of the voting rights of the other entity. The remaining voting rights are held by numerous other shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has arrangements to consult any of the others or make collective decisions. Decisions about the relevant activities of the other entity require the approval of a majority of votes cast at relevant shareholders' meetings—75 per cent of the voting rights of the other entity have been cast at recent relevant shareholders' meetings. In this case, the active participation of the other shareholders at recent shareholders' meetings indicates that the entity would not have the practical ability to direct the relevant activities unilaterally, regardless of whether the entity has directed the relevant activities because a sufficient number of other shareholders voted in the same way as the entity.

Potential Voting Rights (paragraphs AG49–AG52)

IE10. The following examples illustrate assessments of whether potential voting rights are substantive for the purposes of this Standard.

Example 23

Entity A holds 70 per cent of the voting rights of another entity. Entity B has 30 per cent of the voting rights of the other entity as well as an option to acquire half of Entity A's voting rights. The option is exercisable for the next two years at a fixed price that is deeply out of the money (and is expected to remain so for that two-year period). Entity A has been exercising its votes and is actively directing the relevant activities of the other entity. In such a case, Entity A is likely to meet the power criterion because it appears to have the current ability to direct the relevant activities. Although Entity B has currently exercisable options to purchase additional voting rights (that, if exercised, would give it a majority of the voting rights in the other entity), the terms and conditions associated with those options are such that the options are not considered substantive.

Example 24

Entity A and two other investors each hold a third of the voting rights of another entity. The other entity's business activity is closely related to Entity A. In addition to its equity instruments, Entity A also holds debt instruments that are convertible into ordinary shares of the other entity at any time for a fixed price that is out of the money (but not deeply out of the money). If the debt were converted, Entity A would hold 60 per cent of the voting rights of the other entity. Entity A would benefit from realizing synergies if the debt instruments were converted into ordinary shares. Entity A has power over the other entity because it holds voting rights of the other entity together with substantive potential voting rights that give it the current ability to direct the relevant activities.

Power when Voting or Similar Rights do not have a Significant Effect on Benefits (paragraphs AG53–AG56)

IE11. The following examples illustrate assessments of whether an entity has power in the absence of voting rights or similar rights for the purposes of this Standard.

Example 25

A central government has legislation that governs the establishment of cultural and heritage boards. These boards have a separate legal status and have limited liability. The powers and objectives of the boards, along with their reporting requirements are specified by legislation. The main function of each board is to administer the board's assets, mainly property, for the general benefit of beneficiaries. Boards are permitted to spend money on the promotion of health, education, vocational training, and the social and economic welfare of the beneficiaries. They have limited authority to spend money unless it is for a purpose specifically mentioned in the legislation. Each board must deliver an annual financial report to the government. The beneficiaries (as defined by each board and comprising people from a specified area) elect the members of the board. Trustees are appointed for a three-year term by way of voting by beneficiaries at the annual general meeting. Each board determines its own operating and financial policies and strategy. The activities that have the biggest impact on the achievement of the boards' objectives are the management of property and the distribution of funds to the beneficiaries.

The central government does not control the boards. The government was involved in establishing the legislation that governs the activities of the boards, but does not have rights over the relevant activities of the boards.

Example 26

Five local authorities create a separate company to deliver shared services to participating authorities. The company operates under contract to these local authorities. The company's major objective is the provision of services to these local authorities.

The company is owned by all of the participating local authorities with each owning one share and allowed one vote. The chief executive of each local government is permitted to be a board member of the company. The board of the company is responsible for strategic direction, approval of business cases and monitoring of performance.

For each shared activity there is an advisory group that is responsible for operational management and decision-making in relation to that activity. Each advisory group consists of one representative from each local government.

The benefits of the shared services arrangement are:

- Improved levels and quality of service;
- A co-ordinated and consistent approach to the provision of services;
- Reductions in the cost of support and administrative services;
- Opportunities to develop new initiatives; and
- Economies of scale resulting from a single entity representing many councils in procurement.

If further shared service activities are established that lead to the need for further capital, the company will either issue a new class of equity instrument or will form a controlled entity to hold the interest in the new assets.

The company covers its costs in two ways. It retains a percentage of savings from its bulk purchasing activities and it charges an administrative transaction cost of services provided to the local authorities.

None of the local authorities individually controls the company. In deciding how to account for its interest in the company each local authority would also need to consider whether it is a party to a joint arrangement as defined in IPSAS 37, *Joint Arrangements*.

Example 27

A leisure trust was established as a charity, limited by guarantee, to operate and manage sport and leisure facilities on behalf of a local government. Under the terms of the agreement with the local government, the leisure trust is responsible for the operational management, delivery and development of the city's sports and leisure facilities. The trust is required to operate the existing leisure facilities of the local government. The level of service required, including hours of operation and staffing levels, are specified by the local government. The leisure trust's activities must be consistent with the long-term plan of the local government and a significant portion of the trusts activities are funded by the local government. The leisure trust may not create new facilities nor may it engage in any other activities without the approval of the local government.

If the leisure trust ceases to operate the proceeds must be distributed to another charity with similar purposes. The local government is not responsible for the debts of the leisure trust (its liability is limited to one currency unit).

The local government controls the leisure trust. By specifying in detail the way in which the leisure trust must operate the local government has predetermined the leisure trust's activities and the nature of benefits to the local government.

Example 28

A local government transfers its leisure centers, libraries and theatres into a charitable trust.

In creating the trust the local government expects to benefit from cost savings, increased use of facilities by the public, a more favorable taxation treatment, and better access to funding restricted to charities. The trust can decide the nature and extent of facilities to be provided and can engage in any other charitable purpose. The board of the trust is elected by the community. The local government is entitled to have one representative on the board. The trust is required to retain any surplus and use it for the objectives of the trust.

The local government benefits from the trust's activities but it does not control the trust. The local government cannot direct how the trust uses its resources.

Example 29

Trust A promotes, supports and undertakes programs, actions and initiatives to beautify City A. It receives funding from the local government for various services, including graffiti removal, beautification projects and running environmental events. It reports back to the local government on its performance in delivering these services. If the trust did not exist the local government would need to find some other way to deliver these services. The trust also receives assistance through donations and volunteer work by the local community including local businesses, schools, community groups and individuals.

The trust was originally established by an elected official of the local government.

The governing body of the local government appoints all the trustees (having regard to certain requirements such as balance in gender and location of trustees). There are between five and 12 trustees. The trustees appoint the officers.

Changes to the trust deed must be approved by the trustees and the governing body of the local authority.

If the trust is wound up, surplus assets must be transferred to a similar charitable body in the same geographical area. This transfer of assets is subject to the approval of the local government.

The local government has a mix of rights over the trust including rights to:

(a) Appoint, reassign or remove members of the trust's key management personnel who have the ability to direct the relevant activities;

(b) Approve or veto operating and capital budgets relating to the relevant activities of the trust; and

(c) Veto key changes to the trust, such as the sale of a major asset or of the trust as a whole.

The local government is able to direct the relevant activities (the services) of the trust through its arrangements in such a way that it is able to affect the costs and quality of the services being provided. The local government is exposed to variable returns (both the economic effects of the service and the quality of the service). As it uses its power to affect these returns, the local government controls the trust.

Example 30

Entity A is a public sector body that promotes the construction of new houses, the repair and modernization of existing houses, and the improvement of housing and living conditions. It also facilitates access to housing finance and promotes competition and efficiency in the provision of housing finance.

Entity A established a separate trust which has narrowly defined objectives. The trust's functions are to acquire interests in eligible housing loans and issue mortgage bonds. Entity A guarantees the bonds issued by the trust but does not provide ongoing funding – the trust finances its activities through the revenue from its investments. If the trust is wound up the trust's assets are to be distributed to one or more charitable organizations. Entity A does not have on-going decision-making rights over the trust's activities.

Entity A has power over the relevant activities of the trust because it determined the relevant activities of the trust when it established the trust. Entity A is also exposed to variable benefits both through its exposure to the guaranteed bonds and because the trust's activities, determined by Entity A in establishing the trust, help Entity A to achieve its objectives.

Example 31

A funding agency was established by legislation. It is owned by ten local authorities and the central government. It operates on a for-profit basis. The funding agency will raise debt funding and provide that funding to the participating local authorities. Its primary purpose is to provide more efficient funding costs and diversified funding sources for the local authorities. It may undertake any other activities considered by the board to be reasonably related or incidental to, or in connection with, that business.

The main benefits to the participating local authorities are the reduced borrowing costs. The board of the funding agency may decide to pay dividends but dividend payments are expected to be low.

The board is responsible for the strategic direction and control of the funding agency's activities. The board will comprise between four and seven directors with a majority of independent directors.

There is also a shareholders' council which is made up of ten appointees of the shareholders (including an appointee from the central government). The role of the shareholders' council is to:

- Review the performance of the funding agency and the Board, and report to shareholders on that performance;
- Make recommendations to shareholders as to the appointment, removal, replacement and remuneration of directors; and
- Coordinate shareholders' governance decisions.

The funding agency purchases debt securities in accordance with its lending and/or investment policies, as approved by the board and/or shareholders.

To participate in the funding agency as a principal shareholding authority, each local government made an initial capital investment of CU100,000, provided security against future property taxes and agreed to borrow a set portion of its borrowing needs from the funding agency for a period of three years.

Neither the central government nor the participating local authorities control the funding agency. In deciding how to account for their interest in the funding agency the central government and participating local authorities would also need to consider whether they are parties to a joint arrangement as defined in IPSAS 37.

Example 32

Entity A's only business activity, as specified in its founding documents, is to purchase receivables and service them on a day-to-day basis for Entity B. The servicing on a day-to-day basis includes the collection and passing on of principal and interest payments as they fall due. Upon default of a receivable Entity A automatically puts the receivable to Entity B as agreed separately in a put agreement between Entity A and Entity B. The only relevant activity is managing the receivables upon default because it is the only activity that can significantly affect Entity A's financial performance. Managing the receivables before default is not a relevant activity because it does not require substantive decisions to be made that could significantly affect Entity A's financial performance—the activities before default are predetermined and amount only to collecting cash flows as they fall due and passing them on to Entity B. Therefore, only Entity B's right to manage the assets upon default should be considered when assessing the overall activities of Entity A that significantly affect Entity A's financial performance. In this example, the design of Entity A ensures that Entity B has decision-making authority over the activities that significantly affect the financial performance at the only time that such decision-making authority is required. The terms of the put agreement are integral to the overall transaction and the establishment of Entity A. Therefore, the terms of the put agreement together with the founding documents of Entity A lead to the conclusion that Entity B has power over Entity A even though Entity B takes ownership of the receivables only upon default and manages the defaulted receivables outside the legal boundaries of Entity A.

Exposure, or Rights, to Variable Benefits from another Entity (paragraph AG57)

IE12. The following examples illustrate assessments of whether an entity receives variable benefits from another entity for the purposes of this Standard.

Example 33

Research has shown that family friendly policies at universities, which include the provision of quality early childhood education services, are critical in attracting and retaining students and staff. This is particularly important for attracting high-level staff and post-graduate students, which in turn help uphold the reputation of the University and its ability to obtain research funding.

The above background information is relevant to examples 33A and 33B described below. Each example is considered in isolation.

Example 33A

University A has established seven childcare centers (although University A receives government funding for its educational programs, the childcare centers have been established by the university, not by the government). The centers operate in University owned buildings. Each center has its own manager, staff and budget. The centers are able to be used by university staff and students only. The University is the licensed provider of childcare services. The University has the right to close centers or relocate them to other properties. Because the childcare center is on university property the staff and parents are required to comply with University health and safety policies. The management team of the childcare center has the ability to determine all other operating policies.

University A receives non-financial benefits from having childcare services available on campus. Although University A is not involved in the day-to-day running of the centers, it has the ability to close the centers or change their hours of operation.

University A controls the childcare centers.

Example 33B

University B has made a building available free of charge for the provision of childcare services on the grounds of the University. The childcare services are provided by an incorporated society. All parents using the childcare center are members of the society. The members appoint the Board of the incorporated society and are in charge of the childcare center's operating and financial policies. The childcare center is able to be used by staff, students and the general public, with students having priority. Because the childcare center is on University property the staff and parents are required to comply with University health and safety policies. The incorporated society is the licensed provider of childcare services. If the incorporated society ceases to operate, its resources must be distributed to a similar non-profit organization. The incorporated society could choose not to use the University's buildings in providing its services.

Although the University receives non-financial benefits from having childcare services available on campus it does not have power to direct the relevant activities of the incorporated society. The members of the incorporated society, being the parents of the children, have the power to direct the relevant activities of the incorporated society. The University does not control the incorporated society.

Link between Power and Benefits

Delegated Power (paragraphs AG60–AG63)

IE13. The following examples illustrate assessments of whether an entity is acting as a principal or an agent for the purposes of this Standard.

Example 34

A government department may be responsible for monitoring the performance of another public sector entity. The role of the monitoring department is to make sure the other entity's approach is consistent with the government's goals, provide Ministers with quality assurance about delivery and results and assess and notify the Minister of any risks. The department has an explicit agreement with the Minister which sets out its monitoring responsibilities. The department has the authority to request information from the other entity and provides advice to the Minister on any funding requests from that entity. The department also advises the Minister as to whether the other entity should be permitted to undertake certain activities. The department is acting as an agent of the Minister.

Example 35

A provincial government establishes a trust to co-ordinate fundraising efforts for the benefit of health programs and other health initiatives in the region. The trust also invests and manages designated endowment funds. The funds raised are applied to the government-owned hospitals and aged care facilities in the region.

The provincial government appoints all the trustees on the board of the trust and funds the trust's operating costs. The trust is a registered charity and is exempt from income tax.

Based on the following analysis, the provincial government controls the trust:

(a) The provincial government can give directions to the trustees, and the trustees have the current ability to direct the relevant activities of the trust. The trustees have power over the trust and the provincial government can replace the trustees at its discretion. The trustees' fiduciary obligation to act in the best interest of the beneficiaries does not prevent the provincial government from having power over the trust;

(b) The provincial government has exposure and rights to variable benefits from involvement with the trust;

(c) The provincial government can use its power over the trust to affect the nature or amount of the trust's benefits; and

(d) The activities of the trust are complementary to the activities of the provincial government.

Example 36

A statutory body is established under legislation to deliver services to the community. The statutory body has a governing council that oversees the body's operations and is responsible for its day-to-day operations. The Minister of Health for the provincial government appoints the statutory body's governing council and, subject to the Minister's approval, the statutory body's governing council appoints the chief executive of the body.

The provincial government's Health Department acts as the "system manager" for the provincial public health system. This role includes:

(a) Strategic leadership, such as the development of provincial-wide health service plans;

(b) Directions for the delivery of health services, such as entering into service agreements, capital works approval and management of provincial-wide industrial relations, including employment terms and conditions for the statutory body's employees; and

(c) Monitoring of performance (e.g., quality of health services and financial data) of the authority and taking remedial action when performance does not meet specified performance measures.

The Minister's approval is specifically required for the following major decisions:

(a) Entering into service agreements with the body;

(b) Issuing binding health service directives;

(c) Finalization of health service plans and capital works planning; and

(d) Employment and remuneration of the statutory body's executive staff.

The Health Department receives all its operating and capital funding from the provincial government.

Based on the facts and circumstances outlined above, the Health Department generally acts as an agent of the Minister in relation to the statutory body. This is evident from the restricted decision-making authority held by the Department. The Health Department does not control the statutory body.

As the Minister appoints the statutory body's governing council and approves the major decisions affecting the body's activities, the Minister has the power to direct the relevant activities of the body. Assuming that the other control criteria (variable returns and link between power and benefits) are satisfied, as would be expected, then the Minister would control the statutory body. As a result, the statutory body would be consolidated in the provincial government's whole of government general purpose financial statements.

Example 37

The facts are the same as in Example 36 except that:

(a) The Minister has delegated the power to appoint members of the statutory body's governing council to the Health Department's head;

(b) The appointment of the statutory body's chief executive by the governing council does not require the Minister's approval;

(c) The Minister has delegated the power to approve the major decisions to the Health Department's head; and

(d) Assessments of the Health Department's performance encompass the performance of the statutory body.

The Minister could still exercise the powers that have been delegated to the Health Department's head, but in practice, is unlikely to do so.

In this example, the scope of the decision-making authority held by the Health Department has increased significantly as a result of the delegations by the Minister to the Health Department head. As the Health Department acts as a principal under the delegations, the Department has the current ability to direct the relevant activities of the statutory body so as to achieve the health service objectives of the Health Department. As the Health Department also has the ability to use its power over the authority to affect the nature or amount of the Department's benefits, the Department controls the statutory body.

Example 38

The head of the government department related to finance and taxation (the Treasury) is designated by law as the managing trustee for a number of investment funds. The investment funds are funded by designated taxes and are used to deliver federal welfare programs. The Treasury collects most of the designated tax revenue that relates to these funds. Other agencies also collect some of the revenues and forward these to the Treasury.

The Treasury is delegated the responsibility for administering the funds. For each of the funds, the Treasury immediately invests all receipts credited to the fund, and maintains the invested assets in a designated trust fund until money is needed by the relevant agency.

When the relevant agencies determine that monies are needed, the Treasury redeems securities from the funds' investment balances, and transfers the cash proceeds, including interest earned on the investments, to the program accounts for disbursement by the agency. The Treasury provides monthly and other periodic reporting to each agency. The Treasury charges a management fee for its services.

The Treasury does not control the funds.

Example 39

A local government administers ten funds, each relating to a specific district. The funds hold specified assets (such as land, property and investments) that belonged to districts that previously had their own local government but which have since been amalgamated with other districts. The funds receive the revenue associated with the assets and certain taxes such as the property taxes for that district. The rights of the funds to hold these specified assets and receive the specified revenue are set out in legislation. The assets and revenue of the fund may be applied solely for the benefit of the inhabitants of the former districts.

The local government has wide discretion over spending by the funds. Funds must be applied for the benefit of the community in such a manner as using reasonable judgment the local government thinks proper and having regard to the interests of the inhabitants of the former district. The local government may apply the fund to spending which is not covered by council taxation. Expenditure charged to the fund must be for purposes permitted by law.

The funds are controlled by the local government.

Example 40

A sovereign wealth fund (the fund) is a constitutionally established permanent fund, managed by a government corporation. Legislation specifies that the fund is entitled to receive at least 25% of proceeds from oil sales. The fund sets aside a certain share of these revenues to benefit current and future generations of citizens.

The corporation manages the assets of both the fund and certain other state investments and is remunerated for doing so. The corporation may not spend the fund revenue. Decisions on spending fund revenue are made by the Parliament. Each year, the fund's revenue is split between operating expenses and an annual payment to residents that meet certain criteria specified in legislation.

The corporation does not control the sovereign wealth fund. It acts solely as an agent.

Example 41

A decision maker (fund manager) establishes, markets and manages a publicly traded, regulated fund according to narrowly defined parameters set out in the investment mandate as required by its local laws and regulations. The fund was marketed to investors as an investment in a diversified portfolio of equity securities of publicly traded entities. Within the defined parameters, the fund manager has discretion about the assets in which to invest. The fund manager has made a 10 per cent pro rata investment in the fund and receives a market-based fee for its services equal to 1 per cent of the net asset value of the fund. The fees are commensurate with the services provided. The fund manager does not have any obligation to fund losses beyond its 10 per cent investment. The fund is not required to establish, and has not established, an independent board of directors. The investors do not hold any substantive rights that would affect the decision-making authority of the fund manager, but can redeem their interests within particular limits set by the fund.

Although operating within the parameters set out in the investment mandate and in accordance with the regulatory requirements, the fund manager has decision-making rights that give it the current ability to direct the relevant activities of the fund—the investors do not hold substantive rights that could affect the fund manager's decision-making authority. The fund manager receives a market-based fee for its services that is commensurate with the services provided and has also made a pro rata investment in the fund. The remuneration and its investment expose the fund manager to variability of benefits from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal.

In this example, consideration of the fund manager's exposure to variability of benefits from the fund together with its decision-making authority within restricted parameters indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Example 42

A decision maker establishes, markets and manages a fund that provides investment opportunities to a number of investors. The decision maker (fund manager) must make decisions in the best interests of all investors and in accordance with the fund's governing agreements. Nonetheless, the fund manager has wide decision-making discretion. The fund manager receives a market-based fee for its services equal to 1 per cent of assets under management and 20 per cent of all the fund's surplus if a specified level of surplus is achieved. The fees are commensurate with the services provided.

Although it must make decisions in the best interests of all investors, the fund manager has extensive decision-making authority to direct the relevant activities of the fund. The fund manager is paid fixed and performance-related fees that are commensurate with the services provided. In addition, the remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund, without creating exposure to variability of benefits from the activities of the fund that is of such significance that the remuneration, when considered in isolation, indicates that the fund manager is a principal.

The above fact pattern and analysis applies to examples 42A-42C described below. Each example is considered in isolation.

Example 42A

The fund manager also has a 2 per cent investment in the fund that aligns its interests with those of the other investors. The fund manager does not have any obligation to fund losses beyond its 2 per cent investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.

The fund manager's 2 per cent investment increases its exposure to variability of benefits from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal. The other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. In this example, although the fund manager has extensive decision-making authority and is exposed to variability of benefits from its interest and remuneration, the fund manager's exposure indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Example 42B

The fund manager has a more substantial pro rata investment in the fund, but does not have any obligation to fund losses beyond that investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.

In this example, the other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's investment together with its remuneration could create exposure to variability of benefits from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. The greater the magnitude of, and variability associated with, the fund manager's economic interests (considering its remuneration and other interests in aggregate), the more emphasis the fund manager would place on those economic interests in the analysis, and the more likely the fund manager is a principal.

For example, having considered its remuneration and the other factors, the fund manager might consider a 20 per cent investment to be sufficient to conclude that it controls the fund. However, in different circumstances (i.e., if the remuneration or other factors are different), control may arise when the level of investment is different.

Example 42C

The fund manager has a 20 per cent pro rata investment in the fund, but does not have any obligation to fund losses beyond its 20 per cent investment. The fund has a board of directors, all of whose members are independent of the fund manager and are appointed by the other investors. The board appoints the fund manager annually. If the board decided not to renew the fund manager's contract, the services performed by the fund manager could be performed by other managers in the industry.

Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's 20 per cent investment together with its remuneration creates exposure to variability of benefits from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. However, the investors have substantive rights to remove the fund manager—the board of directors provides a mechanism to ensure that the investors can remove the fund manager if they decide to do so.

In this example, the fund manager places greater emphasis on the substantive removal rights in the analysis. Thus, although the fund manager has extensive decision-making authority and is exposed to variability of benefits of the fund from its remuneration and investment, the substantive rights held by the other investors indicate that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Example 43

Entity A is created to purchase a portfolio of fixed rate asset-backed securities, funded by fixed rate debt instruments and equity instruments. The equity instruments are designed to provide first loss protection to the debt investors and receive any residual benefits from Entity A. The transaction was marketed to potential debt investors as an investment in a portfolio of asset-backed securities with exposure to the credit risk associated with the possible default of the issuers of the asset-backed securities in the portfolio and to the interest rate risk associated with the management of the portfolio. On formation, the equity instruments represent 10 per cent of the value of the assets purchased. A decision maker (the asset manager) manages the active asset portfolio by making investment decisions within the parameters set out in Entity A's prospectus. For those services, the asset manager receives a market-based fixed fee (i.e., 1 per cent of assets under management) and performance-related fees (i.e., 10 per cent of surplus) if Entity A's surpluses exceed a specified level. The fees are commensurate with the services provided. The asset manager holds 35 per cent of the equity instruments of Entity A. The remaining 65 per cent of the equity instruments, and all the debt instruments of Entity A, are held by a large number of widely dispersed unrelated third party investors. The asset manager can be removed, without cause, by a simple majority decision of the other investors.

The asset manager is paid fixed and performance-related fees that are commensurate with the services provided. The remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund. The asset manager has exposure to variability of returns from the activities of the fund because it holds 35 per cent of the equity instruments and from its remuneration.

Although operating within the parameters set out in Entity A's prospectus, the asset manager has the current ability to make investment decisions that significantly affect Entity A's benefits in the form of returns—the removal rights held by the other investors receive little weighting in the analysis because those rights are held by a large number of widely dispersed investors. In this example, the asset manager places greater emphasis on its exposure to variability of returns of the fund from its net asset/equity interest, which is subordinate to the debt instruments. Holding 35 per cent of the equity instruments creates subordinated exposure to losses and rights to returns of Entity A, which are of such significance that it indicates that the asset manager is a principal. Thus, the asset manager concludes that it controls Entity A.

Example 44

A decision maker (the sponsor) sponsors a multi-seller conduit, which issues short-term debt instruments to unrelated third party investors. The transaction was marketed to potential investors as an investment in a portfolio of highly rated medium-term assets with minimal exposure to the credit risk associated with the possible default by the issuers of the assets in the portfolio. Various transferors sell high quality medium-term asset portfolios to the conduit. Each transferor services the portfolio of assets that it sells to the conduit and manages receivables on default for a market-based servicing fee. Each transferor also provides first loss protection against credit losses from its asset portfolio through over-collateralization of the assets transferred to the conduit. The sponsor establishes the terms of the conduit and manages the operations of the conduit for a market-based fee. The fee is commensurate with the services provided. The sponsor approves the sellers permitted to sell to the conduit, approves the assets to be purchased by the conduit and makes decisions about the funding of the conduit. The sponsor must act in the best interests of all investors.

The sponsor is entitled to any residual benefit from the conduit and also provides credit enhancement and liquidity facilities to the conduit. The credit enhancement provided by the sponsor absorbs losses of up to 5 per cent of all of the conduit's assets, after losses are absorbed by the transferors. The liquidity facilities are not advanced against defaulted assets. The investors do not hold substantive rights that could affect the decision-making authority of the sponsor.

Even though the sponsor is paid a market-based fee for its services that is commensurate with the services provided, the sponsor has exposure to variability of benefits from the activities of the conduit because of its rights to any residual benefits from the conduit and the provision of credit enhancement and liquidity facilities (i.e., the conduit is exposed to liquidity risk by using short-term debt instruments to fund medium-term assets). Even though each of the transferors has decision-making rights that affect the value of the assets of the conduit, the sponsor has extensive decision-making authority that gives it the current ability to direct the activities that most significantly affect the benefits from the conduit (i.e., the sponsor established the terms of the conduit, has the right to make decisions about the assets (approving the assets purchased and the transferors of those assets) and the funding of the conduit (for which new investment must be found on a regular basis)). The right to residual benefits from the conduit and the provision of credit enhancement and liquidity facilities expose the sponsor to variability of benefits from the activities of the conduit that is different from that of the other investors. Accordingly, that exposure indicates that the sponsor is a principal and thus the sponsor concludes that it controls the conduit. The sponsor's obligation to act in the best interest of all investors does not prevent the sponsor from being a principal.

Accounting requirements: loss of control (paragraphs 52–55A)

IE13A. The following example illustrates the treatment of a sale of an interest in a controlled entity that does not contain an operation.

Example 44A

A controlling entity has a 100 per cent interest in a controlled entity that does not contain an operation. The controlling entity sells 70 per cent of its interest in the controlled entity to an associate in which it has a 20 per cent interest. As a consequence of this transaction, the controlling entity loses control of the controlled entity. The carrying amount of the net assets of the subsidiary is CU100 and the carrying amount of the interest sold is CU70 (CU70 = CU100 × 70%). The fair value of the consideration received is CU210, which is also the fair value of the interest sold. The investment retained in the former controlled entity is an associate accounted for using the equity method and its fair value is CU90. The gain determined in accordance with paragraphs 54–55, before the elimination required by paragraph 55A, is CU200 (CU200 = CU210 + CU90 – CU100). This gain comprises two parts:

(a) The gain (CU140) resulting from the sale of the 70 per cent interest in the controlled entity to the associate. This gain is the difference between the fair value of the consideration received (CU210) and the carrying amount of the interest sold (CU70). According to paragraph 55A, the controlling entity recognizes in its surplus or deficit the amount of the gain attributable to the unrelated investors' interests in the existing associate. This is 80 per cent of this gain, that is CU112 (CU112 = CU140 × 80%). The remaining 20 per cent of the gain (CU28 = CU140 × 20%) is eliminated against the carrying amount of the investment in the existing associate.

(b) The gain (CU60) resulting from the remeasurement at fair value of the investment directly retained in the former controlled entity. This gain is the difference between the fair value of the investment retained in the former controlled entity (CU90) and 30 per cent of the carrying amount of the net assets of the controlled entity (CU30 = CU100 × 30%). According to paragraph 55A, the controlling entity recognizes in its surplus or deficit the amount of the gain attributable to the unrelated investors' interests in the new associate. This is 56 per cent (70% × 80%) of the gain, that is CU34 (CU34 = CU60 × 56%). The remaining 44 per cent of the gain CU26 (CU26 = CU60 × 44%) is eliminated against the carrying amount of the investment retained in the former controlled entity.

Investment Entities (paragraphs AG88–AG106)

IE14. The following examples illustrate assessments of whether an entity is an investment entity for the purposes of this Standard.

Example 45

An entity, Limited Partnership, is formed in 20X1 as a limited partnership with a 10-year life. The offering memorandum states that Limited Partnership's purpose is to invest in entities with rapid growth potential, with the objective of realizing capital appreciation over their life. Entity GP (the general partner of Limited Partnership) provides 1 per cent of the capital to Limited Partnership and has the responsibility of identifying suitable investments for the partnership. Approximately 75 limited partners, who are unrelated to Entity GP, provide 99 per cent of the capital to the partnership.

Limited Partnership begins its investment activities in 20X1. However, no suitable investments are identified by the end of 20X1. In 20X2 Limited Partnership acquires a controlling interest in one entity, ABC Corporation. Limited Partnership is unable to close another investment transaction until 20X3, at which time it acquires equity interests in five additional operating companies. Other than acquiring these equity interests, Limited Partnership conducts no other activities. Limited Partnership measures and evaluates its investments on a fair value basis and this information is provided to Entity GP and the external investors.

Limited Partnership has plans to dispose of its interests in each of its investees during the 10 year stated life of the partnership. Such disposals include the outright sale for cash, the distribution of marketable equity securities to investors following the successful public offering of the investees' securities and the disposal of investments to the public or other unrelated entities.

From the information provided, Limited Partnership meets the definition of an investment entity from formation in 20X1 to 31 December 20X3 because the following conditions exist:

(a) Limited Partnership has obtained funds from the limited partners and is providing those limited partners with investment management services;

(b) Limited Partnership's only activity is acquiring equity interests in operating companies with the purpose of realizing capital appreciation over the life of the investments. Limited Partnership has identified and documented exit strategies for its investments, all of which are equity investments; and

(c) Limited Partnership measures and evaluates its investments on a fair value basis and reports this financial information to its investors.

In addition, Limited Partnership displays the following characteristics that are relevant in assessing whether it meets the definition of an investment entity:

(a) Limited Partnership is funded by many investors; and

(b) Ownership in Limited Partnership is represented by units of partnership interests acquired through a capital contribution.

Limited Partnership does not hold more than one investment throughout the period. However, this is because it was still in its start-up period and had not identified suitable investment opportunities.

Example 46

High Technology Fund was formed by Technology Corporation to invest in technology start-up companies for capital appreciation. Technology Corporation holds a 70 per cent interest in High Technology Fund and controls High Technology Fund; the other 30 per cent ownership interest in High Technology Fund is owned by 10 investors. Technology Corporation holds options to acquire investments held by High Technology Fund, at their fair value, which would be exercised if the technology developed by the investees would benefit the operations of Technology Corporation. No plans for exiting the investments have been identified by High Technology Fund. High Technology Fund is managed by an investment adviser that acts as agent for the investors in High Technology Fund.

Even though High Technology Fund's purpose is investing for capital appreciation and it provides investment management services to its investors, High Technology Fund is not an investment entity because of the following arrangements and circumstances:

(a) Technology Corporation, the controlling entity of High Technology Fund, holds options to acquire investments in investments held by High Technology Fund if the assets developed by those entities would benefit the operations of Technology Corporation. This provides a benefit in addition to capital appreciation or investment revenue; and

(b) The investment plans of High Technology Fund do not include exit strategies for its investments, which are equity investments. The options held by Technology Corporation are not controlled by High Technology Fund and do not constitute an exit strategy.

Example 47

Real Estate Entity was formed to develop, own and operate retail, office and other commercial properties. Real Estate Entity typically holds its property in separate wholly-owned controlled entities, which have no other substantial assets or liabilities other than borrowings used to finance the related investment property. Real Estate Entity and each of its controlled entities report their investment properties at fair value in accordance with IPSAS 16, *Investment Property*. Real Estate Entity does not have a set time frame for disposing of its property investments, but uses fair value to help identify the optimal time for disposal. Although fair value is one performance indicator, Real Estate Entity and its investors use other measures, including information about expected cash flows, rental revenues and expenses, to assess performance and to make investment decisions. The key management personnel of Real Estate Entity do not consider fair value information to be the primary measurement attribute to evaluate the performance of its investments but rather a part of a group of equally relevant key performance indicators.

Real Estate Entity undertakes extensive property and asset management activities, including property maintenance, capital expenditure, redevelopment, marketing and tenant selection, some of which it outsources to third parties. This includes the selection of properties for refurbishment, development and the negotiation with suppliers for the design and construction work to be done to develop such properties. This development activity forms a separate substantial part of Real Estate Entity's activities.

Real Estate Entity does not meet the definition of an investment entity because:

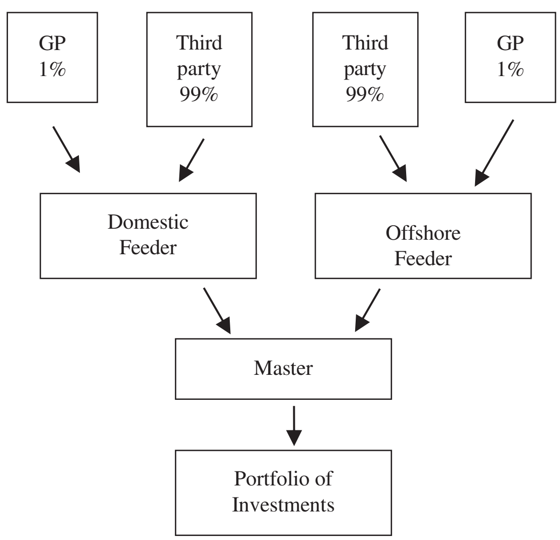
(a) Real Estate Entity has a separate substantial activity that involves the active management of its property portfolio, including lease negotiations, refurbishments and development activities, and marketing of properties to provide benefits other than capital appreciation, investment revenue, or both;

(b) The investment plans of Real Estate Entity do not include specified exit strategies for its investments. As a result, Real Estate Entity plans to hold those property investments indefinitely; and

(c) Although Real Estate Entity reports its investment properties at fair value in accordance with IPSAS 16, fair value is not the primary measurement attribute used by management to evaluate the performance of its investments. Other performance indicators are used to evaluate performance and make investment decisions.

Example 48

An entity, Master Fund, is formed in 20X1 with a 10-year life. The equity of Master Fund is held by two related feeder funds. The feeder funds are established in connection with each other to meet legal, regulatory, tax or similar requirements. The feeder funds are capitalized with a 1 per cent investment from the general partner and 99 per cent from equity investors that are unrelated to the general partner (with no party holding a controlling financial interest).



The purpose of Master Fund is to hold a portfolio of investments in order to generate capital appreciation and investment revenue (such as dividends, interest or rental revenue). The investment objective communicated to investors is that the sole purpose of the Master-Feeder structure is to provide investment opportunities for investors in separate market niches to invest in a large pool of assets. Master Fund has identified and documented exit strategies for the equity and non-financial investments that it holds. Master Fund holds a portfolio of short and medium term debt investments, some of which will be held until maturity and some of which will be traded but Master Fund has not specifically identified which investments will be held and which will be traded. Master Fund measures and evaluates substantially all of its investments, including its debt investments, on a fair value basis. In addition, investors receive periodic financial information, on a fair value basis, from the feeder funds. Ownership in both Master Fund and the feeder funds is represented through units of equity.

Master Fund and the feeder funds each meet the definition of an investment entity. The following conditions exist:

(a) Both Master Fund and the feeder funds have obtained funds for the purpose of providing investors with investment management services;

(b) The Master-Feeder structure's purpose, which was communicated directly to investors of the feeder funds, is investing solely for capital appreciation and investment revenue and Master Fund has identified and documented potential exit strategies for its equity and non-financial investments;

(c) Although the feeder funds do not have an exit strategy for their interests in Master Fund, the feeder funds can nevertheless be considered to have an exit strategy for their investments because Master Fund was formed in connection with the feeder funds and holds investments on behalf of the feeder funds; and

(d) The investments held by Master Fund are measured and evaluated on a fair value basis and information about the investments made by Master Fund is provided to investors on a fair value basis through the feeder funds.

Master Fund and the feeder funds were formed in connection with each other for legal, regulatory, tax or similar requirements. When considered together, they display the following characteristics:

(a) The feeder funds indirectly hold more than one investment because Master Fund holds a portfolio of investments;

(b) Although Master Fund is wholly capitalized by the feeder funds, the feeder funds are funded by many investors who are unrelated to the feeder funds (and to the general partner); and

(c) Ownership in the feeder funds is represented by units of equity interests acquired through a capital contribution.

Example 49

Government Corporation A was established with the principal activity of providing equity finance to both existing and new enterprises. Its investment objective is to seek capital appreciation and returns. All acquisitions are made on that basis. The strategy of the Corporation is to increase the fair value of investments in order to realize a gain on disposal. Management assesses and monitors fair value of the investments on a regular basis. The Corporation regularly disposes of investments when they reach a certain stage of maturity so as to provide funds for ongoing investment opportunities. Any surplus is distributed to the government in the form of dividends.

The Corporation also provides investment related services to the government regarding the government's policies for assisting entities in financial distress. It acts as an agent in managing and implementing some of the government's business incentive schemes. The Corporation is not exposed to any losses or risks as a result of its involvement with these schemes.

The Corporation is an investment entity. It meets all three aspects of the definition of an investment entity.

Comparison with IFRS 10

IPSAS 35, *Consolidated Financial Statements* is drawn primarily from IFRS 10, *Consolidated Financial Statements* (issued in 2011, including amendments up to December 31, 2014). At the time of issuing this Standard, the IPSASB has not considered the applicability to public sector entities of certain IFRSs referred to in IFRS 10. These standards include:

- IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*; and
- IFRS 9, *Financial Instruments*.

The main differences between IPSAS 35 and IFRS 10 are as follows:

- IPSAS 35 uses different terminology, in certain instances, from IFRS 10. The most significant examples are the use of the terms "economic entity," "controlling entity," and "controlled entity". The equivalent terms in IFRS 10 are "group," "parent," and "subsidiary." In many cases the terms "investor" and "investee" used in IFRS 10 are replaced by references to "an entity", "another entity" or "an entity being assessed for control". The terms "investor" and "investee" have been retained in the application guidance on investment entities as they are appropriate in that context.
- IPSAS 35 defines the term "binding arrangement". This term is broader than the term "contractual arrangement", which is used in IFRS 10.
- IFRS 10 identifies typical characteristics of an investment entity separately from the definition of an investment entity. IPSAS 35 does not identify such typical characteristics. However, it does discuss some of these characteristics in the context of the definition of an investment entity.
- IPSAS 35 contains more guidance on non-financial benefits.
- IPSAS 35 does not require that a controlling entity, that is not itself an investment entity, shall consolidate all controlled entities. Instead it requires that such a controlling entity shall present consolidated financial statements in which it (i) measures the investments of the controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 29 and (ii) consolidates the other assets and liabilities and revenue and expenses of the controlled investment entity in accordance with IPSAS 35.
- IPSAS 35 contains additional illustrative examples that reflect the public sector context.

IPSAS 36—INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 28, *Investments in Associates and Joint Ventures* published by the International Accounting Standards Board (IASB). Extracts from IAS 28 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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IPSAS 36—INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 36, *Investments in Associates and Joint Ventures* was issued in January 2015.

Since then, IPSAS 36 has been amended by the following IPSASs:

- *COVID-19: Deferral of Effective Dates* (issued November 2020)
- Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41)
- *Improvements to IPSAS 2018* (issued October 2018)
- IPSAS 41, *Financial Instruments* (issued August 2018)
- IPSAS 40, *Public Sector Combinations* (issued January 2017)
- *The Applicability of IPSASs* (issued April 2016)
- *Improvements to IPSASs 2015* (issued April 2016)

Table of Amended Paragraphs in IPSAS 36

Paragraph Affected	How Affected	Affected By
4	Amended	Improvements to IPSASs April 2016
6	Deleted	The Applicability of IPSASs April 2016
7	Deleted	The Applicability of IPSASs April 2016
20	Amended	IPSAS 41 August 2018
20A	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41) January 2019
24	Amended	IPSAS 41 August 2018 Improvements to IPSAS October 2018
25	Amended	IPSAS 41 August 2018
26	Amended	IPSAS 40 January 2017 IPSAS 41 August 2018
31	Amended	IPSAS 40 January 2017
33	Amended	IPSAS 40 January 2017
34A	New	IPSAS 40 January 2017
34B	New	IPSAS 40 January 2017
43	Amended	IPSAS 41 August 2018
44	Deleted	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41) January 2019
44A	New	IPSAS 41 August 2018
44B	New	IPSAS 41 August 2018
44C	New	IPSAS 41 August 2018

Paragraph Affected	How Affected	Affected By
45	Amended	IPSAS 41 August 2018
51A	New	The Applicability of IPSASs April 2016
51B	New	IPSAS 40 January 2017
51C	New	IPSAS 40 January 2017
51D	Amended	COVID-19: Deferral of Effective Dates November 2020
51E	New	Improvements to IPSAS October 2018
51F	Amended	COVID-19: Deferral of Effective Dates November 2020
51G	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41) January 2019
51H	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41) January 2019
51I	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41) January 2019
Illustrative Example	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41) January 2019

IPSAS 36—INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

CONTENTS

International Public Sector Accounting Standard 36, *Investments in Associates and Joint Ventures*, is set out in paragraphs 1–53. All the paragraphs have equal authority. IPSAS 36 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting for investments in associates and joint ventures and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for investments in associates and joint ventures.**

3. **This Standard shall be applied by all entities that are investors with significant influence over, or joint control of, an investee where the investment leads to the holding of a quantifiable ownership interest.**

4. This Standard provides the basis for accounting for ownership interests in associates and joint ventures. That is, the investment in the other entity confers on the entity the risks and rewards incidental to an ownership interest. This Standard applies only to quantifiable ownership interests. This includes ownership interests arising from investments in the formal equity structure of another entity. A formal equity structure means share capital or an equivalent form of capital, such as units in a property trust. Quantifiable ownership interests may also include ownership interests arising from other investments in which the entity's ownership interest can be measured reliably[1] (for example, interests in a partnership). Where the equity structure of the other entity is poorly defined, it may not be possible to obtain a reliable measure of the ownership interest.

5. Some contributions made by public sector entities may be referred to as an "investment," but may not give rise to an ownership interest. For example, a public sector entity may make a substantial investment in the development of a hospital that is owned and operated by a charity. While such contributions are non-exchange in nature, they allow the public sector entity to participate in the operation of the hospital, and the charity is accountable to the public sector entity for its use of public monies. However, the contributions made by the public sector entity do not constitute an ownership interest, as the charity could seek alternative funding and thereby prevent the public sector entity from participating in the operation of the hospital. Accordingly, the public sector entity is not exposed to the risks, nor does it enjoy the rewards, that are incidental to an ownership interest.

6. [Deleted]

7. [Deleted]

Definitions

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

An associate is an entity over which the investor has significant influence.

Binding arrangement: For the purposes of this Standard, a binding arrangement is an arrangement that confers enforceable rights and obligations on the parties to it as if it were in the form of a contract. It includes rights from contracts or other legal rights.

Consolidated financial statements are the financial statements of an economic entity in which assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity and its controlled entities are presented as those of a single economic entity.

The equity method is a method of accounting whereby the investment is initially recognized at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets/equity of the associate or joint venture. The investor's surplus or deficit includes its share of the investee's surplus or deficit and the investor's net assets/equity includes its share of changes in the investee's net assets/equity that have not been recognized in the investee's surplus or deficit.

A joint arrangement is an arrangement of which two or more parties have joint control.

Joint control is the agreed sharing of control of an arrangement by way of a binding arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

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[1] Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent. Paragraph BC16 of IPSAS 1 discusses the transitional approach to the explanation of reliability.

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

A joint venturer is a party to a joint venture that has joint control of that joint venture.

Significant influence is the power to participate in the financial and operating policy decisions of another entity but is not control or joint control of those policies.

Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately. The following terms are defined in either IPSAS 34, *Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements*, or IPSAS 37, *Joint Arrangements*: benefits, control, controlled entity, controlling entity, economic entity, investment entity, joint operation, power and separate financial statements.

Binding Arrangement

9. Binding arrangements can be evidenced in several ways. A binding arrangement is often, but not always, in writing, in the form of a contract or documented discussions between the parties. Statutory mechanisms such as legislative or executive authority can also create enforceable arrangements, similar to contractual arrangements, either on their own, or in conjunction with contracts between the parties.

Significant Influence

10. Whether an investor has significant influence over the investee is a matter of judgment based on the nature of the relationship between the investor and the investee, and on the definition of significant influence in this Standard. This Standard applies only to those associates in which an entity holds a quantifiable ownership interest either in the form of a shareholding or other formal equity structure or in another form in which the entity's interest can be measured reliably.

11. If an entity holds a quantifiable ownership interest and it holds, directly or indirectly (e.g., through controlled entities), 20 per cent or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the entity holds, directly or indirectly (e.g., through controlled entities), less than 20 per cent of the voting power of the investee, it is presumed that the entity does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.

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

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

    (b) Participation in policy-making processes, including participation in decisions about dividends or similar distributions;

    (c) Material transactions between the entity and its investee;

    (d) Interchange of managerial personnel; or

    (e) Provision of essential technical information.

13. An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity additional voting power or to reduce another party's voting power over the financial and operating policies of another entity (i.e., potential voting rights). The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities, are considered when assessing whether an entity has significant influence. Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.

14. In assessing whether potential voting rights contribute to significant influence, the entity examines all facts and circumstances (including the terms of exercise of the potential voting rights and any other binding arrangements whether considered individually or in combination) that affect potential rights, except the intentions of management and the financial ability to exercise or convert those potential rights.

15. An entity loses significant influence over an investee when it loses the power to participate in the financial and operating policy decisions of that investee. The loss of significant influence can occur with or without a change in absolute or relative ownership levels. It could occur, for example, when an associate becomes subject to the control of another government, a court or an administrator. It could also occur as a result of a binding arrangement.

Equity Method

16. Under the equity method, on initial recognition the investment in an associate or a joint venture is recognized at cost and the carrying amount is increased or decreased to recognize the investor's share of the surplus or deficit of the investee after the date of acquisition. The investor's share of the investee's surplus or deficit is recognized in the investor's surplus or deficit. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's equity that have not been recognized in the investee's surplus or deficit. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognized in net assets/equity of the investor.

17. The recognition of revenue on the basis of distributions received may not be an adequate measure of the revenue earned by an investor on an investment in an associate or a joint venture because the distributions received may bear little relation to the performance of the associate or joint venture. Because the investor has joint control of, or significant influence over, the investee, the investor has an interest in the associate's or joint venture's performance and, as a result, the return on its investment. The investor accounts for this interest by extending the scope of its financial statements to include its share of the surplus or deficit of such an investee. As a result, application of the equity method provides more informative reporting of the investor's net assets/equity and surplus or deficit.

18. When potential voting rights or other derivatives containing potential voting rights exist, an entity's interest in an associate or a joint venture is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivative instruments, unless paragraph 19 applies.

19. In some circumstances, an entity has, in substance, an existing ownership interest as a result of a transaction that currently gives it access to the benefits associated with an ownership interest. In such circumstances, the proportion allocated to the entity is determined by taking into account the eventual exercise of those potential voting rights and other derivative instruments that currently give the entity access to the benefits.

20. IPSAS 41, *Financial Instruments* does not apply to interests in associates and joint ventures that are accounted for using the equity method. When instruments containing potential voting rights in substance currently give access to the benefits associated with an ownership interest in an associate or a joint venture, the instruments are not subject to IPSAS 41. In all other cases, instruments containing potential voting rights in an associate or a joint venture are accounted for in accordance with IPSAS 41.

20A. An entity also applies IPSAS 41 to other financial instruments in an associate or joint venture to which the equity method is not applied. These include long-term interests that, in substance, form part of the entity's net investment in an associate or joint venture (see paragraph 41). An entity applies IPSAS 41 to such long-term interests before it applies paragraph 41 and paragraphs 43–48 of this Standard. In applying IPSAS 41 the entity does not take account of any adjustments to the carrying amount of long-term interests that arise from applying this Standard.

21. **An investment in an associate or a joint venture accounted for using the equity method shall be classified as a non-current asset.**

Application of the Equity Method

22. **An entity with joint control of, or significant influence over, an investee shall account for its investment in an associate or a joint venture using the equity method except when that investment qualifies for exemption in accordance with paragraphs 23–25.**

Exemptions from Applying the Equity Method

23. An entity need not apply the equity method to its investment in an associate or a joint venture if the entity is a controlling entity that is exempt from preparing consolidated financial statements by the scope exception in paragraph 5 of IPSAS 35 or if all of the following apply:

    (a) The entity itself is a controlled entity and the information needs of users are met by its controlling entity's consolidated financial statements, and, in the case of a partially owned entity, all 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 organization, for the purpose of issuing any class of instruments in a public market.

(d) The ultimate or any intermediate controlling entity of the entity produces financial statements available for public use that comply with IPSASs, in which controlled entities are consolidated or are measured at fair value in accordance with IPSAS 35.

24. When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that investment at fair value through surplus or deficit in accordance with IPSAS 41[2]. An entity shall make this election separately for each associate or joint venture, at initial recognition of the associate or joint venture. An investment entity will, by definition, have made this election for its investments.

25. When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through surplus or deficit in accordance with IPSAS 41 regardless of whether the venture capital organization, or the mutual fund, unit trust and similar entities including investment-linked insurance funds, has significant influence over that portion of the investment. If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds. When an entity has an investment in an associate, a portion of which is held indirectly through an investment entity, the entity shall measure that portion of the investment at fair value through surplus or deficit in accordance with IPSAS 41.

Discontinuing the Use of the Equity Method

26. **An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture as follows:**

(a) **If the investment becomes a controlled entity, the entity shall account for its investment in accordance with IPSAS 40, *Public Sector Combinations* and IPSAS 35.**

(b) **If the retained interest in the former associate or joint venture is a financial asset, the entity shall measure the retained interest at fair value. The fair value of the retained interest shall be regarded as its fair value on initial recognition as a financial asset in accordance with IPSAS 41. The entity shall recognize in surplus or deficit any difference between:**

(i) **The fair value of any retained interest and any proceeds from disposing of a part interest in the associate or joint venture; and**

(ii) **The carrying amount of the investment at the date the equity method was discontinued.**

(c) **When an entity discontinues the use of the equity method, the entity shall account for all amounts previously recognized directly in the entity's net assets/equity in relation to that investment on the same basis as would have been required if the investee had directly disposed of the related assets or liabilities.**

27. **If an investment in an associate becomes an investment in a joint venture or an investment in a joint venture becomes an investment in an associate, the entity continues to apply the equity method and does not remeasure the retained interest.**

Changes in Ownership Interest

28. If an entity's ownership interest in an associate or a joint venture is reduced, but the investment continues to be classified either as an associate or a joint venture respectively, the entity shall transfer directly to accumulated surpluses or deficits the proportion of the gain or loss that had previously been recognized in net assets/equity relating to that reduction in ownership interest if that gain or loss would be required to be transferred directly to accumulated surpluses or deficits on the disposal of the related assets or liabilities.

Equity Method Procedures

29. Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IPSAS 35. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a controlled entity are also adopted in accounting for the acquisition of an investment in an associate or a joint venture.

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[2] Or IPSAS 29, *Financial Instruments: Recognition and Measurement*, where an entity has not yet applied IPSAS 41.

30. An economic entity's share in an associate or a joint venture is the aggregate of the holdings in that associate or joint venture by the controlling entity and its controlled entities. The holdings of the economic entity's other associates or joint ventures are ignored for this purpose. When an associate or a joint venture has controlled entities, associates or joint ventures, the surplus or deficit and net assets taken into account in applying the equity method are those recognized in the associate's or joint venture's financial statements (including the associate's or joint venture's share of the surpluses or deficits and net assets of its associates and joint ventures), after any adjustments necessary to give effect to uniform accounting policies (see paragraphs 37–39).

31. Gains and losses resulting from "upstream" and "downstream" transactions involving assets that do not constitute an operation, as defined in IPSAS 40, between an entity (including its consolidated controlled entities) and its associate or joint venture are recognized in the entity's financial statements only to the extent of unrelated investors' interests in the associate or joint venture. "Upstream" transactions are, for example, sales of assets from an associate or a joint venture to the investor. The entity's share in the associate's or the joint venture's gains or losses resulting from these transactions is eliminated. "Downstream" transactions are, for example, sales or contributions of assets from the investor to its associate or its joint venture.

32. When downstream transactions provide evidence of a reduction in the net realizable value of the assets to be sold or contributed, or of an impairment loss of those assets, those losses shall be recognized in full by the investor. When upstream transactions provide evidence of a reduction in the net realizable value of the assets to be purchased or of an impairment loss of those assets, the investor shall recognize its share in those losses.

33. The gain or loss resulting from the contribution of non-monetary assets that do not constitute an operation, as defined in IPSAS 40, to an associate or a joint venture in exchange for an equity interest in that associate or joint venture shall be accounted for in accordance with paragraph 31, except when the contribution lacks commercial substance, as that term is described in IPSAS 17, *Property, Plant and Equipment.* If such a contribution lacks commercial substance, the gain or loss is regarded as unrealized and is not recognized unless paragraph 34 also applies. Such unrealized gains and losses shall be eliminated against the investment accounted for using the equity method and shall not be presented as deferred gains or losses in the entity's consolidated statement of financial position or in the entity's statement of financial position in which investments are accounted for using the equity method.

34. If, in addition to receiving an equity interest in an associate or a joint venture, an entity receives monetary or non-monetary assets, the entity recognizes in full in surplus or deficit the portion of the gain or loss on the contribution relating to the monetary or non-monetary assets received.

34A. The gain or loss resulting from a downstream transaction involving assets that constitute an operation, as defined in IPSAS 40, between an entity (including its consolidated controlled entities) and its associate or joint venture is recognized in full in the investor's financial statements.

34B. An entity might sell or contribute assets in two or more arrangements (transactions). When determining whether assets that are sold or contributed constitute an operation, as defined in IPSAS 40, an entity shall consider whether the sale or contribution of those assets is part of multiple arrangements that should be accounted for as a single transaction in accordance with the requirements in paragraph 53 of IPSAS 35.

35. An investment is accounted for using the equity method from the date on which it becomes an associate or a joint venture. On acquisition of the investment, any difference between the cost of the investment and the entity's share of the net fair value of the investee's identifiable assets and liabilities is accounted for as follows:

(a) When an entity has included goodwill relating to an associate or a joint venture in the carrying amount of the investment, amortization of that goodwill is not permitted.

(b) Any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is included as revenue in the determination of the entity's share of the associate or joint venture's surplus or deficit in the period in which the investment is acquired.

Appropriate adjustments to the entity's share of the associate's or joint venture's surplus or deficit after acquisition are made in order to account, for example, for depreciation of the depreciable assets based on their fair values at the acquisition date. Similarly, appropriate adjustments to the entity's share of the associate's or joint venture's surplus or deficit after acquisition are made for impairment losses such as for property, plant and equipment or, where relevant, goodwill.

36. **The most recent available financial statements of the associate or joint venture are used by the entity in applying the equity method. When the end of the reporting period of the entity is different from that of an associate or a joint venture the entity either:**

(a) **Obtains, for the purpose of applying the equity method, additional financial information as of the same date as the financial statements of the entity; or**

(b) **Uses the most recent financial statements of the associate or joint venture adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the entity's financial statements.**

37. **The entity's financial statements shall be prepared using uniform accounting policies for like transactions and events in similar circumstances.**

38. Except as described in paragraph 39, if an associate or a joint venture uses accounting policies other than those of the entity for like transactions and events in similar circumstances, adjustments shall be made to make the associate's or joint venture's accounting policies conform to those of the entity when the associate's or joint venture's financial statements are used by the entity in applying the equity method.

39. **Notwithstanding the requirements in paragraph 38, if an entity has an interest in an associate or a joint venture that is an investment entity, the entity shall, when applying the equity method, retain the fair value measurement applied by that investment entity associate or joint venture to its interest in controlled entities.**

40. If an associate or a joint venture has outstanding cumulative preference shares that are held by parties other than the entity and are classified as equity, the entity computes its share of surplus or deficit after adjusting for the dividends on such shares, whether or not the dividends have been declared.

41. If an entity's share of the deficit of an associate or a joint venture equals or exceeds its interest in the associate or joint venture, the entity discontinues recognizing its share of further deficits. The interest in an associate or a joint venture is the carrying amount of the investment in the associate or joint venture determined using the equity method together with any long-term interests that, in substance, form part of the entity's net investment in the associate or joint venture. For example, an item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension of the entity's investment in that associate or joint venture. Such items may include preference shares and long-term receivables or loans, but do not include trade receivables, trade payables or any long-term receivables for which adequate collateral exists, such as secured loans. Deficits recognized using the equity method in excess of the entity's investment in ordinary shares are applied to the other components of the entity's interest in an associate or a joint venture in the reverse order of their seniority (i.e. priority in liquidation).

42. After the entity's interest is reduced to zero, additional deficits are provided for, and a liability is recognized, only to the extent that the entity has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture. If the associate or joint venture subsequently reports surpluses, the entity resumes recognizing its share of those surpluses only after its share of the surpluses equals the share of deficits not recognized.

Impairment Losses

43. After application of the equity method, including recognizing the associate's or joint venture's deficits in accordance with paragraph 41, the entity applies paragraphs 44A–44C to determine whether there is any objective evidence that its net investment in the associate or joint venture is impaired.

44. [Deleted]

44A. The net investment in an associate or joint venture is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the net investment (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows from the net investment that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment. Rather the combined effect of several events may have caused the impairment. Losses expected as a result of future events, no matter how likely, are not recognized. Objective evidence that the net investment is impaired includes observable data that comes to the attention of the entity about the following loss events:

(a) Significant financial difficulty of the associate or joint venture;

(b) A breach of contract, such as a default or delinquency in payments by the associate or joint venture;

(c) The entity, for economic or legal reasons relating to its associate's or joint venture's financial difficulty, granting to the associate or joint venture a concession that the entity would not otherwise consider;

(d) It becoming probable that the associate or joint venture will enter bankruptcy or other financial reorganization; or

(e) The disappearance of an active market for the net investment because of financial difficulties of the associate or joint venture.

44B. The disappearance of an active market because the associate's or joint venture's equity or financial instruments are no longer publicly traded is not evidence of impairment. A downgrade of an associate's or joint venture's credit rating or a decline in the fair value of the associate or joint venture, is not of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information.

44C. In addition to the types of events in paragraph 44A, objective evidence of impairment for the net investment in the equity instruments of the associate or joint venture includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the associate or joint venture operates, and indicates that the cost of the investment in the equity instrument may not be recovered. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.

45. Whenever application of paragraphs 44A–44C indicates that the investment in an associate or a joint venture may be impaired, an entity applies IPSAS 26, *Impairment of Cash-Generating Assets*, and possibly, IPSAS 21, *Impairment of Non-Cash-Generating Assets*.

46. IPSAS 26 directs an entity to determine the value in use of the cash-generating investment. In determining the value in use of the cash-generating investment in accordance with IPSAS 26, an entity estimates:

(a) Its share of the present value of the estimated future cash flows expected to be generated by the associate or joint venture, including the cash flows from the operations of the associate or joint venture and the proceeds from the ultimate disposal of the investment; or

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

Using appropriate assumptions, both methods give the same result.

47. IPSAS 21 requires that, if the recoverable service amount of an asset is less than its carrying amount, the carrying amount shall be reduced to its recoverable service amount. Recoverable service amount is the higher of an asset's fair value, less costs to sell and its value in use. Value in use of a non-cash-generating asset is defined as the present value of the asset's remaining service potential. The present value of the remaining service potential may be assessed using the depreciated replacement cost approach, the restoration cost approach or the service units approach, as appropriate.

48. **The recoverable amount of an investment in an associate or a joint venture shall be assessed for each associate or joint venture, unless the associate or joint venture does not generate cash inflows from continuing use that are largely independent of those from other assets of the entity.**

Separate Financial Statements

49. **An investment in an associate or a joint venture shall be accounted for in the entity's separate financial statements in accordance with paragraph 12 of IPSAS 34, *Separate Financial Statements*.**

Transitional Provisions

50. The transitional provisions for changing from proportionate consolidation to the equity method, or from the equity method to accounting for assets and liabilities in respect of a joint operation are set out in IPSAS 37**.**

Effective Date and Transition

51. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2017, it shall disclose that fact and apply IPSAS 34, IPSAS 35, IPSAS 37, and IPSAS 38, *Disclosure of Interests in Other Entities,* at the same time.**

51A. **Paragraphs 6 and 7 were deleted by *The Applicability of IPSASs,* issued in April 2016. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2018, it shall disclose that fact.**

51B. **Paragraph 26 was amended by IPSAS 40, *Public Sector Combinations*, issued in January 2017. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2019. Earlier**

application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2019 it shall disclose that fact and apply IPSAS 40 at the same time.

51C. **Paragraphs 31 and 33 were amended and paragraphs 34A and 34B added by IPSAS 40, *Public Sector Combinations*, issued in January 2017. An entity shall apply these amendments prospectively for annual financial statements covering periods beginning on or after a date to be determined by the IPSASB. Earlier application is permitted. If an entity applies the amendments for a period earlier, it shall disclose that fact and, if it has not already done so, apply IPSAS 40 at the same time.**

51D. **Paragraphs 20, 24, 25, 26, 43, 44 and 45 were amended and paragraphs 44A, 44B and 44C were added by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply IPSAS 41 at the same time.**

51E. **Paragraph 24 was amended by *Improvements to IPSAS, 2018*, issued in October 2018. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2019. Earlier application is permitted. If an entity applies this amendment for a period beginning before January 1, 2019, it shall disclose that fact.**

51F. **Paragraph 20A was added and paragraph 44 deleted by *Long-term Interests in Associates and Joint Ventures* (Amendments to IPSAS 36) and *Prepayment Features with Negative Compensation* (Amendments to IPSAS 41), issued in January 2019. An entity shall apply these amendments retrospectively in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, for annual financial statements covering periods beginning on or after January 1, 2023, except as specified in paragraphs 51G–51I. Earlier application is permitted. If an entity applies these amendments for a period beginning before January 1, 2023, it shall disclose that fact and apply IPSAS 41 at the same time.**

51G. **An entity that first applies the amendments in paragraph 51F at the same time it first applies IPSAS 41 shall apply the transition requirements in IPSAS 41 to the long-term interests described in paragraph 20A.**

51H. **An entity that first applies the amendments in paragraph 51F after it first applies IPSAS 41 shall apply the transition requirements in IPSAS 41 necessary for applying the requirements set out in paragraph 20A to long-term interests. For that purpose, references to the date of initial application in IPSAS 41 shall be read as referring to the beginning of the annual reporting period in which the entity first applies the amendments (the date of initial application of the amendments). The entity is not required to restate prior periods to reflect the application of the amendments. The entity may restate prior periods only if it is possible without the use of hindsight.**

51I. **If an entity does not restate prior periods applying paragraph 51H, at the date of initial application of the amendments it shall recognize in the opening accumulated surplus or deficit (or other component of net assets/equity, as appropriate) any difference between:**

(a) **The previous carrying amount of long-term interests described in paragraph 20A at that date; and**

(b) **The carrying amount of those long-term interests at that date.**

52. When an entity adopts the accrual basis IPSASs as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public sector Accounting Standards (IPSASs)* for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

Withdrawal and Replacement of IPSAS 7 (December 2006)

53. This Standard supersedes IPSAS 7, *Investments in Associates* (December 2006). IPSAS 7 remains applicable until IPSAS 36 is applied or becomes effective, whichever is earlier.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 36.

Objective

BC1. This Basis for Conclusions summarizes the IPSASB's considerations in reaching its conclusions on IPSAS 36. As this Standard is based on IAS 28, *Investments in Associates and Joint Ventures* (Amended in 2011, including amendments up to December 31, 2014) issued by the IASB, the Basis for Conclusions outlines only those areas where IPSAS 36 departs from the main requirements of IAS 28 (Amended in 2011), or where the IPSASB considered such departures.

Overview

BC2. In 2012 the IPSASB commenced work on a project to update those IPSASs that dealt with accounting for interests in controlled entities, associates and joint ventures. In October 2013 the IPSASB issued Exposure Drafts (EDs) 48 to 52 which were collectively referred to as Interests in Other Entities. ED 50, *Investments in Associates and Joint Ventures,* was based on IAS 28 (Amended in 2011), having regard to the relevant public sector modifications in IPSAS 7, *Investments in Associates* and IPSAS 8, *Interests in Joint Ventures.* In January 2015 the IPSASB issued five new IPSASs, including IPSAS 36. These new IPSASs supersede IPSAS 6, *Consolidated and Separate Financial Statements*, IPSAS 7 and IPSAS 8.

BC3. As a result of combining the accounting for associates and joint ventures the title of the Standard was changed to *Investments in Associates and Joint Ventures.*

BC4. In drafting IPSAS 36 the Board did not reconsider all the requirements of IPSAS 7, *Investments in Associates*. The most significant changes resulted from the decision to require the use of the equity method to account for investments in joint ventures and therefore to combine the accounting for investments in associates and joint ventures in one standard. The Board's views on the use of the equity method to account for investments in joint ventures are discussed in the Basis for Conclusions on IPSAS 37.

Scope

Quantifiable Ownership Interests

BC5. The IPSASB noted that the scope of IPSAS 7 had been limited to investments in associates "where the investment in the associate leads to the holding of an ownership interest in the form of a shareholding or other formal equity structure". In developing IPSAS 7 the IPSASB noted that it is unlikely equity accounting could be applied unless the associate had a formal or other reliably measurable equity structure. The IPSASB reflected on the intention of this modification and concluded that it was intended to prevent the inappropriate application of that Standard to interests other than ownership interests.

BC6. In contrast with IPSAS 7 this Standard applies to both associates and joint ventures. Because joint ventures can take many forms, including partnership arrangements which do not have formal equity structures, the scope limitation in IPSAS 7 was not appropriate. The IPSASB decided that the scope of this Standard should be limited to "quantifiable ownership interests". Respondents supported this proposal, but considered that disclosure of information about an entity's non-quantifiable ownership interests in other entities would be appropriate. The IPSASB agreed that IPSAS 38, *Disclosure of Interests in Other Entities* should require the disclosure of non-quantifiable ownership interests.

Temporary Joint Control and Significant Influence

BC7. IPSAS 7 and IPSAS 8, *Interests in Joint Ventures*, did not require application of the equity method or proportionate consolidation when joint control of, or significant influence over, another entity was intended to be temporary. The IPSASB noted that the IASB had removed these exemptions from the equivalent IFRSs in 2003, as a consequence of issuing IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations.*

BC8. The IPSASB noted that in developing IPSAS 35, *Consolidated Financial Statements*, it had considered the related issue of whether to incorporate a temporary control exemption in that Standard, and had agreed not to do so. Accordingly the IPSASB decided not to provide exemptions based on temporary joint control or temporary significant influence in IPSAS 36.

Significant Influence

BC9. The Standard establishes a presumption that an entity has significant influence over an investee if an entity holds an ownership interest in the form of a shareholding or other formal equity structure and holds, directly, or indirectly, (e.g., through controlled entities) 20 per cent or more of the voting power of an investee. The IPSASB noted that the use of

20 percent in establishing a presumption of significant influence came initially from IAS 28 and had also been used in IPSAS 7 (December 2006). In deciding to retain this presumption in the Standard, the IPSASB noted that it was unaware of any public sector reason to use an amount other than 20 per cent.

Uniform Reporting Dates

BC10. The IPSASB considered whether to impose a time limit on the difference between the end of the reporting period of the entity and associate or joint venture of the entity. The IPSASB noted that IAS 28 requires that the most recent available financial statements of the associate or joint venture be used by an entity in applying the equity method and requires adjustments when they are not the same. In addition, IAS 28 limits the difference in dates to three months. The IPSASB noted that there may be instances in the public sector where entities have different reporting dates and it may not be possible to change those dates. The IPSASB agreed not to impose a three month limit on the difference in dates.

Investment Entities

BC11. Some respondents to ED 50 requested that the IPSASB clarify the application of the equity method by investment entities and by investors with investments in an associate or a joint venture that is an investment entity. Accordingly, the IPSASB:

(a) Clarified that an investment entity will, by definition, have elected to account for investments in associates and joint ventures at fair value through surplus or deficit in accordance with IPSAS 41; and

(b) Required that an entity with an interest in an investment entity associate or an investment entity joint venture, shall, when applying the equity method, retain the fair value measurement applied by that investment entity associate or investment entity joint venture to its interests in controlled entities.

BC12. The IPSASB noted that IASB constituents had also sought clarification of some aspects of the accounting for investments in investment entity associates and investment entity joint ventures. The IASB issued ED 2014/2 *Investment Entities–Applying the Consolidation Exception (Proposed amendments to IFRS 10 and IAS 28)* in June 2014 and subsequently issued *Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10, IFRS 12 and IAS 28)* in December 2014.The IPSASB considered that these clarifications were helpful in addressing implementation issues identified by early adopters of the IASB's investment entity requirements and incorporated those aspects of the amendments that were relevant to this Standard.

Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

BC13. At the time that IPSAS 36 was being developed, the IASB amended IFRS 10 and IAS 28 so that the requirements for the recognition of a partial gain or loss for transactions between an investor and its associate or joint venture would apply only to the gain or loss resulting from the sale or contribution of assets that do not constitute a business, as defined in IFRS 3, *Business Combinations*. The IASB issued *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)* in September 2014. The IPSASB agreed not to incorporate the requirements introduced by these amendments in IPSAS 35 and IPSAS 36 on the grounds that it would be more appropriate to consider the recognition of full or partial gains and losses in the context of drafting standards-level requirements for public sector combinations.

BC14. At the time the IPSASB developed ED 60, *Public Sector Combinations***,** it reconsidered whether to include guidance on how to account for the sale or contribution of assets between an investor and its associate or joint venture. The IPSASB reviewed the guidance issued by the IASB in *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28). The effect of the IASB's amendments if adopted in IPSAS 36 would be that a partial gain or loss for transactions between an investor and its associate or joint venture would apply only to the gain or loss resulting from the sale or contribution of assets *that do not constitute an operation.* The IPSASB did not identify any public sector reason to depart from the IASB's approach. Consequently, the IPSASB agreed to include this guidance (amended to fit the terminology and definitions in ED 60) in IPSAS 36.

BC15. In December 2015, the IASB deferred the implementation of the guidance in *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28). This was because the IASB was undertaking further research in this area as part of its project on equity accounting, and it did not want to require entities to change their accounting twice in a short period. In deferring the effective date, the IASB continued to allow early application of the guidance as it did not wish to prohibit the application of better financial reporting. The IPSASB reviewed the decision of the IASB to defer the implementation of this guidance. The IPSASB did not identify any public sector reason to depart from the IASB's approach. Consequently, the IPSASB agreed to include this guidance (amended to fit the terminology and definitions in IPSAS 40) in IPSAS 36, to be applied from a date to be determined by the IPSASB.

Revision of IPSAS 36 as a result of the IPSASB's *The Applicability of IPSASs*, issued in April 2016

BC16. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:

(a) Removes the standard paragraphs about the applicability of IPSASs to "public sector entities other than GBEs" from the scope section of each Standard;

(b) Replaces the term "GBE" with the term "commercial public sector entities", where appropriate; and

(c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.

Revision of IPSAS 36 as a result of *Improvements to IPSAS, 2018*

BC17. The IPSASB reviewed the revisions to IAS 28, *Investments in Associates and Joint Ventures*, included in *Annual Improvements to IFRS Standards 2014–2016 Cycle* issued by the IASB in December 2016, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions. These amendments clarify that an entity is able to choose between applying the equity method or measuring the investment at fair value for each investment in an associate or joint venture.

BC18. In respect of an investment in an associate or a joint venture that is held by, or is held indirectly through, an entity that is a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the IPSASB generally concurred that there was no public sector specific reason for not adopting the amendments.

BC19. However, in respect of an interest in an associate or a joint venture that is an investment entity, the IPSASB had already determined, in approving IPSAS 36 (and in contrast to the approach taken in IAS 28), to mandate fair value measurement. Consequently, the IPSASB did not adopt the amendments made to IAS 28, paragraph 36A.

Revision of IPSAS 36 as a result of *Long-term Interests in Associates and Joint Ventures* (Amendments to IPSAS 36) and *Prepayment Features with Negative Compensation* (Amendments to IPSAS 41)

BC20. The IPSASB reviewed the revisions to IAS 28, *Investments in Associates and Joint Ventures,* included in *Long-term Interests in Associates and Joint Ventures* (Amendments to IAS 28) issued by the IASB in October 2017, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions, and concurred that there was no public sector specific reason for not adopting the amendments.

Revision of IPSAS 36 as a result of *COVID-19: Deferral of Effective Dates*

BC21. The IPSASB published *Long-term Interests in Associates and Joint Ventures* (Amendments to IPSAS 36) and *Prepayment Features with Negative Compensation* (Amendments to IPSAS 41) in January 2019. At the time these amendments were finalized, the Board decided that an entity shall apply them for annual financial statements covering periods beginning on or after January 1, 2022.

BC22. In June 2020, the IPSASB discussed the effect of the COVID-19 pandemic on financial reporting. The Board noted that the pandemic has created significant pressures on the resources public sector entities might otherwise allocate to the implementation of these amendments.

BC23. The Board concluded that deferral during a time of significant disruption would provide much-needed operational relief to public sector entities. Therefore, the Board decided to propose a one-year deferral of the effective date of these amendments.

BC24. The Board did not propose any changes to the amendments other than the deferral of the effective date. Earlier application of the amendments will continue to be permitted.

ILLUSTRATIVE EXAMPLE—LONG-TERM INTERESTS IN ASSOCIATES AND JOINT VENTURES

This example accompanies, but is not part of, IPSAS 36.

This example portrays a hypothetical situation illustrating how an entity (investor) accounts for long-term interests that, in substance, form part of the entity's net investment in an associate (long-term interests) applying IPSAS 41, *Financial Instruments*, and IPSAS 36 based on the assumptions presented. The entity applies IPSAS 41 in accounting for long-term interests. The entity applies IPSAS 36 to its net investment in the associate, which includes long-term interests. The analysis in this example is not intended to represent the only manner in which the requirements in IPSAS 36 could be applied.

Assumptions

The investor has the following three types of interests in the associate:

(a) O Shares—ordinary shares representing a 40% ownership interest to which the investor applies the equity method. This interest is the least senior of the three interests, based on their relative priority in liquidation.

(b) P Shares—non-cumulative preference shares that form part of the net investment in the associate and that the investor measures at fair value through surplus or deficit applying IPSAS 41.

(c) LT Loan—a long-term loan that forms part of the net investment in the associate and that the investor measures at amortized cost applying IPSAS 41 with a stated interest rate and an effective interest rate of 5% a year. The associate makes interest-only payments to the investor each year. The LT Loan is the most senior of the three interests.

The LT Loan is not an originated credit-impaired loan. Throughout the years illustrated, there has not been any objective evidence that the net investment in the associate is impaired applying IPSAS 36, nor does the LT Loan become credit-impaired applying IPSAS 41.

The associate does not have any outstanding cumulative preference shares classified as equity, as described in paragraph 40 of IPSAS 36. Throughout the years illustrated, the associate neither declares nor pays dividends on O Shares or P Shares.

The investor has not incurred any legal or constructive obligations, nor made payments on behalf of the associate, as described in paragraph 42 of IPSAS 36. Accordingly, the investor does not recognize its share of the associate's deficits once the carrying amount of its net investment in the associate is reduced to zero.

The amount of the investor's initial investment in O Shares is CU200[1], in P Shares is CU100 and in the LT Loan is CU100. On acquisition of the investment, the cost of the investment equals the investor's share of the net fair value of the associate's identifiable assets and liabilities.

This table summarizes the carrying amount at the end of each year for P Shares and the LT Loan applying IPSAS 41 but before applying IPSAS 36, and the associate's surplus (deficit) for each year. The amounts for the LT Loan are shown net of the loss allowance.

At the end of	P Shares applying IPSAS 41 (fair value)	LT Loan applying IPSAS 41 (amortized cost)	Surplus (deficit) of the associate
Year 1	CU110	CU90	CU50
Year 2	CU90	CU70	CU(200)
Year 3	CU50	CU50	CU(500)
Year 4	CU40	CU50	CU(150)
Year 5	CU60	CU60	–
Year 6	CU80	CU70	CU500
Year 7	CU110	CU90	CU500

Analysis

Year 1

The investor recognizes the following in Year 1:

[1] In this Illustrative Example, currency amounts are denominated in currency units (CU).

Investments in the associate:		
Dr. O Shares	CU200	
Dr. P Shares	CU100	
Dr. LT Loan	CU100	
Cr. Cash		CU400
To recognize the initial investment in the associate		
Dr. P Shares	CU10	
Cr. Surplus or deficit		CU10
To recognize the change in fair value (CU110 − CU100)		
Dr. Surplus or deficit	CU10	
Cr. Loss allowance (LT Loan)		CU10
To recognize an increase in the loss allowance (CU90 − CU100)		
Dr. O Shares	CU20	
Cr. Surplus or deficit		CU20
To recognize the investor's share of the associate's surplus (CU50 × 40%)		

At the end of Year 1, the carrying amount of O Shares is CU220, P Shares is CU110 and the LT Loan (net of loss allowance) is CU90.

Year 2

The investor recognizes the following in Year 2:

Dr. Surplus or deficit	CU20	
Cr. P Shares		CU20
To recognize the change in fair value (CU90 − CU110)		
Dr. Surplus or deficit	CU20	
Cr. Loss allowance (LT Loan)		CU20
To recognize an increase in the loss allowance (CU70 – CU90)		
Dr. Surplus or deficit	CU80	
Cr. O Shares		CU80
To recognize the investor's share of the associate's deficit (CU200 × 40%)		

At the end of Year 2, the carrying amount of O Shares is CU140, P Shares is CU90 and the LT Loan (net of loss allowance) is CU70.

Year 3

Applying paragraph 20A of IPSAS 36, the investor applies IPSAS 41 to P Shares and the LT Loan before it applies paragraph 41 of IPSAS 36. Accordingly, the investor recognizes the following in Year 3:

Dr. Surplus or deficit	CU40	
Cr. P Shares		CU40
To recognize the change in fair value (CU50 − CU90)		
Dr. Surplus or deficit	CU20	
Cr. Loss allowance (LT Loan)		CU20
To recognize an increase in the loss allowance (CU50 – CU70)		
Dr. Surplus or deficit	CU200	
Cr. O Shares		CU140
Cr. P Shares		CU50
Cr. LT Loan		CU10
To recognize the investor's share of the associate's deficit in reverse order of seniority as specified in paragraph 41 of IPSAS 36 (CU500 × 40%)		

At the end of Year 3, the carrying amount of O Shares is zero, P Shares is zero and the LT Loan (net of loss allowance) is CU40.

Year 4

Applying IPSAS 41 to its interests in the associate, the investor recognizes the following in Year 4:

Dr. Surplus or deficit	CU10	
Cr. P Shares		CU10

To recognize the change in fair value (CU40 − CU50)

Recognition of the change in fair value of CU10 in Year 4 results in the carrying amount of P Shares being negative CU10. Consequently, the investor recognizes the following to reverse a portion of the associate's deficits previously allocated to P Shares:

Dr. P Shares	CU10	
Cr. Surplus or deficit		CU10

To reverse a portion of the associate's deficits previously allocated to P Shares

Applying paragraph 41 of IPSAS 36, the investor limits the recognition of the associate's deficits to CU40 because the carrying amount of its net investment in the associate is then zero. Accordingly, the investor recognizes the following:

Dr. Surplus or deficit	CU40	
Cr. LT Loan		CU40

To recognize the investor's share of the associate's deficit

At the end of Year 4, the carrying amount of O Shares is zero, P Shares is zero and the LT Loan (net of loss allowance) is zero. There is also an unrecognized share of the associate's deficits of CU30 (the investor's share of the associate's cumulative deficits of CU340 – CU320 deficits recognized cumulatively + CU10 deficits reversed).

Year 5

Applying IPSAS 41 to its interests in the associate, the investor recognizes the following in Year 5:

Dr. P Shares	CU20	
Cr. Surplus or deficit		CU20

To recognize the change in fair value (CU60 − CU40)

Dr. Loss allowance (LT Loan)	CU10	
Cr. Surplus or deficit		CU10

To recognize a decrease in the loss allowance (CU60 – CU50)

After applying IPSAS 41 to P Shares and the LT Loan, these interests have a positive carrying amount. Consequently, the investor allocates the previously unrecognized share of the associate's deficits of CU30 to these interests.

Dr. Surplus or deficit	CU30	
Cr. P Shares		CU20
Cr. LT Loan		CU10

To recognize the previously unrecognized share of the associate's deficits

At the end of Year 5, the carrying amount of O Shares is zero, P Shares is zero and the LT Loan (net of loss allowance) is zero.

Year 6

Applying IPSAS 41 to its interests in the associate, the investor recognizes the following in Year 6:

Dr. P Shares	CU20	
Cr. Surplus or deficit		CU20

To recognize the change in fair value (CU80 − CU60)

Dr. Loss allowance (LT Loan)	CU10	
Cr. Surplus or deficit		CU10

To recognize a decrease in the loss allowance (CU70 – CU60)

The investor allocates the associate's surplus to each interest in the order of seniority. The investor limits the amount of the associate's surplus it allocates to P Shares and the LT Loan to the amount of equity method deficits previously allocated to those interests, which in this example is CU60 for both interests.

Dr. O Shares	CU80	
Dr. P Shares	CU60	
Dr. LT Loan	CU60	
Cr. Surplus or deficit		CU200
To recognize the investor's share of the associate's surplus (CU500 × 40%)		

At the end of Year 6, the carrying amount of O Shares is CU80, P Shares is CU80 and the LT Loan (net of loss allowance) is CU70.

Year 7

The investor recognizes the following in Year 7:

Dr. P Shares	CU30	
Cr. Surplus or deficit		CU30
To recognize the change in fair value (CU110 − CU80)		
Dr. Loss allowance (LT Loan)	CU20	
Cr. Surplus or deficit		CU20
To recognize a decrease in the loss allowance (CU90 – CU70)		
Dr. O Shares	CU200	
Cr. Surplus or deficit		CU200
To recognize the investor's share of the associate's surplus (CU500 × 40%)		

At the end of Year 7, the carrying amount of O Shares is CU280, P Shares is CU110 and the LT Loan (net of loss allowance) is CU90.

Years 1–7

When recognizing interest revenue on the LT Loan in each year, the investor does not take account of any adjustments to the carrying amount of the LT Loan that arose from applying IPSAS 36 (paragraph 20A of IPSAS 36). Accordingly, the investor recognizes the following in each year:

Dr. Cash	CU5	
Cr. Surplus or deficit		CU5
To recognize interest revenue on LT Loan based on the effective interest rate of 5%		

Summary of amounts recognized in surplus or deficit

This table summarizes the amounts recognized in the investor's surplus or deficit.

Items recognized **During**	**Impairment (losses), including reversals, applying IPSAS 41**	**Gains (losses) of P Shares applying IPSAS 41**	**Share of surplus (deficit) of the associate recognized applying the equity method**	**Interest revenue applying IPSAS 41**
Year 1	CU(10)	CU10	CU20	CU5
Year 2	CU(20)	CU(20)	CU(80)	CU5
Year 3	CU(20)	CU(40)	CU(200)	CU5
Year 4	–	CU(10)	CU(30)	CU5
Year 5	CU10	CU20	CU(30)	CU5
Year 6	CU10	CU20	CU200	CU5
Year 7	CU20	CU30	CU200	CU5

Comparison with IAS 28 (Amended in 2011)

IPSAS 36, *Investments in Associates and Joint Ventures* is drawn primarily from IAS 28, *Investments in Associates and Joint Ventures* (Amended in 2011, including amendments up to December 31, 2014). At the time of issuing this Standard, the IPSASB has not considered the applicability to public sector entities of IFRS 9, *Financial Instruments*. References to IFRS 9 in IAS 28 have therefore been replaced by references to the IPSASs dealing with financial instruments.

The main differences between IPSAS 36 and IAS 28 (Amended in 2011) are as follows:

- IPSAS 36 uses different terminology, in certain instances, from IAS 28 (Amended in 2011). The most significant examples are the use of the terms "net assets/equity," "economic entity," "controlling entity," "controlled entity" and "revenue" in IPSAS 36. The equivalent terms in IAS 28 (Amended in 2011) are "equity," "group," "parent," "subsidiary" and "income."
- IPSAS 36 applies to all investments where the investor has a quantifiable ownership interest. IAS 28 (Amended in 2011) does not contain a similar requirement. However, it is unlikely that equity accounting could be applied unless there was a quantifiable ownership interest.
- Where an entity is precluded by IPSAS 29 from measuring the retained interest in a former associate or joint venture at fair value, IPSAS 36 permits an entity to use carrying amount as the cost on initial recognition of the financial asset. IAS 28 (Amended in 2011) requires that the retained interest be measured at fair value.
- IPSAS 36 requires that an entity with an interest in an associate or a joint venture that is an investment entity, shall, when applying the equity method, retain the fair value measurement applied by that investment entity associate or joint venture to its interest in controlled entities. IAS 28 (Amended in 2011) permits an entity with an interest in an associate or a joint venture that is an investment entity to retain the fair value measurement applied by that investment entity associate or joint venture.

IPSAS 37—JOINT ARRANGEMENTS

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Financial Reporting Standard (IFRS) 11, *Joint Arrangements* published by the International Accounting Standards Board (IASB). Extracts from IFRS 11 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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IPSAS 37—JOINT ARRANGEMENTS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 37, *Joint Arrangements* was issued in January 2015.

Since then, IPSAS 37 has been amended by the following IPSASs:

- *COVID-19: Deferral of Effective Dates* (issued November 2020)
- *Improvements to IPSAS 2018* (issued October 2018)
- IPSAS 41, *Financial Instruments* (issued August 2018)
- IPSAS 40, *Public Sector Combinations* (issued January 2017)
- *The Applicability of IPSASs* (issued April 2016)

Table of Amended Paragraphs in IPSAS 37

Paragraph Affected	How Affected	Affected By
5	Deleted	The Applicability of IPSASs April 2016
6	Deleted	The Applicability of IPSASs April 2016
24A	New	IPSAS 40 January 2017
28	Amended	IPSAS 41 August 2018
30	Amended	IPSAS 41 August 2018
32	Amended	IPSAS 40 January 2017
41	Amended	IPSAS 41 August 2018
41A	New	IPSAS 40 January 2017
42A	New	The Applicability of IPSASs April 2016
42B	New	IPSAS 40 January 2017
42C	New	IPSAS 40 January 2017
42D	Amended	COVID-19: Deferral of Effective Dates November 2020
42E	New	Improvements to IPSAS October 2018
AG11	Amended	IPSAS 41 August 2018
AG33A	Amended	IPSAS 40 January 2017 IPSAS 41 August 2018
AG33B	New	IPSAS 40 January 2017
AG33C	New	IPSAS 40 January 2017
AG33CA	New	Improvements to IPSAS October 2018
AG33D	New	IPSAS 40 January 2017

IPSAS 37—JOINT ARRANGEMENTS

CONTENTS

International Public Sector Accounting Standard 37, *Joint Arrangements*, is set out in paragraphs 1–44. All the paragraphs have equal authority. IPSAS 37 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (i.e., joint arrangements).

2. To meet the objective in paragraph 1, this Standard defines joint control and requires an entity that is a party to a joint arrangement to determine the type of joint arrangement in which it is involved by assessing its rights and obligations and to account for those rights and obligations in accordance with that type of joint arrangement.

Scope

3. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in determining the type of joint arrangement in which it is involved and in accounting for the rights and obligations of the joint arrangement.**

4. **This Standard shall be applied by all entities that are a party to a joint arrangement.**

5. [Deleted]

6. [Deleted]

Definitions

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

Binding arrangement: For the purposes of this Standard, a binding arrangement is an arrangement that confers enforceable rights and obligations on the parties to it as if it were in the form of a contract. It includes rights from contracts or other legal rights.

A joint arrangement is an arrangement of which two or more parties have joint control.

Joint control is the agreed sharing of control of an arrangement by way of a binding arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.

A joint operator is a party to a joint operation that has joint control of that joint operation.

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

A joint venturer is a party to a joint venture that has joint control of that joint venture.

A party to a joint arrangement is an entity that participates in a joint arrangement, regardless of whether that entity has joint control of the arrangement.

A separate vehicle is a separately identifiable financial structure, including separate legal entities or entities recognized by statute, regardless of whether those entities have a legal personality.

Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately. The following terms are defined in IPSAS 34, *Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements* or IPSAS 36, *Investments in Associates and Joint Ventures*: benefits, control, equity method, power, protective rights, relevant activities, separate financial statements and significant influence.

Binding Arrangement

8. Binding arrangements can be evidenced in several ways. A binding arrangement is often, but not always, in writing, in the form of a contract or documented discussions between the parties. Statutory mechanisms such as legislative or executive authority can also create enforceable arrangements, similar to contractual arrangements, either on their own, or in conjunction with contracts between the parties.

Joint Arrangements (see paragraphs AG2–AG33)

9. **A joint arrangement is an arrangement of which two or more parties have joint control.**

10. **A joint arrangement has the following characteristics:**

    (a) **The parties are bound by a binding arrangement (see paragraphs AG2–AG4).**

    (b) **The binding arrangement gives two or more of those parties joint control of the arrangement (see paragraphs 12–18).**

11. **A joint arrangement is either a joint operation or a joint venture.**

Joint Control

12. **Joint control is the sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. The sharing of control may have been agreed by way of a binding arrangement**.

13. **An entity that is a party to an arrangement shall assess whether the binding arrangement gives all the parties, or a group of the parties, control of the arrangement collectively. All the parties, or a group of the parties, control the arrangement collectively when they must act together to direct the activities that significantly affect the benefits from the arrangement (i.e., the relevant activities).**

14. Once it has been determined that all the parties, or a group of the parties, control the arrangement collectively, joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that control the arrangement collectively.

15. In a joint arrangement, no single party controls the arrangement on its own. A party with joint control of an arrangement can prevent any of the other parties, or a group of the parties, from controlling the arrangement.

16. An arrangement can be a joint arrangement even though not all of its parties have joint control of the arrangement. This Standard distinguishes between parties that have joint control of a joint arrangement (joint operators or joint venturers) and parties that participate in, but do not have joint control of, a joint arrangement.

17. **An entity will need to apply judgment when assessing whether all the parties, or a group of the parties, have joint control of an arrangement. An entity shall make this assessment by considering all facts and circumstances (see paragraphs AG5–AG11).**

18. **If facts and circumstances change, an entity shall reassess whether it still has joint control of the arrangement.**

Types of Joint Arrangement

19. **An entity shall determine the type of joint arrangement in which it is involved. The classification of a joint arrangement as a joint operation or a joint venture depends upon the rights and obligations of the parties to the arrangement.**

20. **An entity applies judgment when assessing whether a joint arrangement is a joint operation or a joint venture. An entity shall determine the type of joint arrangement in which it is involved by considering its rights and obligations arising from the arrangement. An entity assesses its rights and obligations by considering the structure and legal form of the arrangement, the terms agreed by the parties or established by legislative or executive authority and, when relevant, other facts and circumstances (see paragraphs AG12–AG33).**

21. Sometimes the parties are bound by a framework agreement that sets up the general terms for undertaking one or more activities. The framework agreement might set out that the parties establish different joint arrangements to deal with specific activities that form part of the agreement. Even though those joint arrangements are related to the same framework agreement, their type might be different if the parties' rights and obligations differ when undertaking the different activities dealt with in the framework agreement. Consequently, joint operations and joint ventures can coexist when the parties undertake different activities that form part of the same framework agreement.

22. **If facts and circumstances change, an entity shall reassess whether the type of joint arrangement in which it is involved has changed.**

Financial Statements of Parties to a Joint Arrangement (see paragraphs AG33A–AG37)

Joint Operations

23. **A joint operator shall recognize in relation to its interest in a joint operation:**

    (a) **Its assets, including its share of any assets held jointly;**

(b) **Its liabilities, including its share of any liabilities incurred jointly;**

(c) **Its revenue from the sale of its share of the output arising from the joint operation;**

(d) **Its share of the revenue from the sale of the output by the joint operation; and**

(e) **Its expenses, including its share of any expenses incurred jointly.**

24. **A joint operator shall account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the IPSASs applicable to the particular assets, liabilities, revenues and expenses.**

24A. **When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes an operation, as defined in IPSAS 40, *Public Sector Combinations,* it shall apply, to the extent of its share in accordance with paragraph 23, all of the principles on acquisition accounting in IPSAS 40, and other IPSASs, that do not conflict with the guidance in this Standard, and disclose the information that is required in those IPSASs in relation to acquisitions. This applies to the acquisition of both the initial interest and additional interests in a joint operation in which the activity of the joint operation constitutes an operation. The accounting for the acquisition of an interest in such a joint operation is specified in paragraphs AG33A–AG33D.**

25. The accounting for transactions such as the sale, contribution or purchase of assets between an entity and a joint operation in which it is a joint operator is specified in paragraphs AG34–AG37.

26. **A party that participates in, but does not have joint control of, a joint operation shall also account for its interest in the arrangement in accordance with paragraphs 23–25 if that party has rights to the assets, and obligations for the liabilities, relating to the joint operation. If a party that participates in, but does not have joint control of, a joint operation does not have rights to the assets, and obligations for the liabilities, relating to that joint operation, it shall account for its interest in the joint operation in accordance with the IPSASs applicable to that interest.**

Joint Ventures

27. **A joint venturer shall recognize its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with IPSAS 36, *Investments in Associates and Joint Ventures,* unless the entity is exempted from applying the equity method as specified in that Standard.**

28. **A party that participates in, but does not have joint control of, a joint venture shall account for its interest in the arrangement in accordance with the IPSASs dealing with financial instruments, being IPSAS 28, *Financial Instruments: Presentation,* IPSAS 30, *Financial Instruments: Disclosures,* and IPSAS 41, *Financial Instruments* unless it has significant influence over the joint venture, in which case it shall account for it in accordance with IPSAS 36.**

Separate Financial Statements

29. **In its separate financial statements, a joint operator or joint venturer shall account for its interest in:**

(a) **A joint operation in accordance with paragraphs 23–25; and**

(b) **A joint venture in accordance with paragraph 12 of IPSAS 34.**

30. **In its separate financial statements, a party that participates in, but does not have joint control of, a joint arrangement shall account for its interest in:**

(a) **A joint operation in accordance with paragraph 26; and**

(b) **A joint venture in accordance with IPSAS 41, unless the entity has significant influence over the joint venture, in which case it shall apply paragraph 12 of IPSAS 34.**

Transitional Provisions

31. **Notwithstanding the requirements of paragraph 33 of IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, when this Standard is first applied, an entity need only present the quantitative information required by paragraph 33(f) of IPSAS 3, for the annual period immediately preceding the first annual period for which this Standard is applied (the 'immediately preceding period'). An entity may also present this information for the current period or for earlier comparative periods, but is not required to do so.**

Joint Ventures—Transition from Proportionate Consolidation to the Equity Method

32. **When changing from proportionate consolidation to the equity method, an entity shall recognize its investment in the joint venture as at the beginning of the immediately preceding period. That initial investment shall be measured as the aggregate of the carrying amounts of the assets and liabilities that the entity had previously proportionately consolidated, including any purchased goodwill arising from acquisition transactions. If the goodwill previously belonged to a larger cash-generating unit, or to a group of cash-generating units, the entity shall allocate goodwill to the joint venture on the basis of the relative carrying amounts of the joint venture and the cash-generating unit or group of cash-generating units to which it belonged.**

33. **The opening balance of the investment determined in accordance with paragraph 32 is regarded as the deemed cost of the investment at initial recognition. An entity shall apply paragraphs 43–48 of IPSAS 36 to the opening balance of the investment to assess whether the investment is impaired and shall recognize any impairment loss as an adjustment to accumulated surplus or deficit at the beginning of the immediately preceding period.**

34. **If aggregating all previously proportionately consolidated assets and liabilities results in negative net assets, an entity shall assess whether it has legal or constructive obligations in relation to the negative net assets and, if so, the entity shall recognize the corresponding liability. If the entity concludes that it does not have legal or constructive obligations in relation to the negative net assets, it shall not recognize the corresponding liability but it shall adjust accumulated surplus or deficit at the beginning of the immediately preceding period. The entity shall disclose this fact, along with its cumulative unrecognized share of losses of its joint ventures as at the beginning of the immediately preceding period and at the date at which this Standard is first applied.**

35. **An entity shall disclose a breakdown of the assets and liabilities that have been aggregated into the single line investment balance as at the beginning of the immediately preceding period. That disclosure shall be prepared in an aggregated manner for all joint ventures for which an entity applies the transition requirements referred to in paragraphs 32–36.**

36. **After initial recognition, an entity shall account for its investment in the joint venture using the equity method in accordance with IPSAS 36.**

Joint Operations—Transition from the Equity Method to Accounting for Assets and Liabilities

37. **When changing from the equity method to accounting for assets and liabilities in respect of its interest in a joint operation, an entity shall, at the beginning of the immediately preceding period, derecognize the investment that was previously accounted for using the equity method and any other items that formed part of the entity's net investment in the arrangement in accordance with paragraph 41 of IPSAS 36 and recognize its share of each of the assets and the liabilities in respect of its interest in the joint operation, including any goodwill that might have formed part of the carrying amount of the investment.**

38. **An entity shall determine its interest in the assets and liabilities relating to the joint operation on the basis of its rights and obligations in a specified proportion in accordance with the binding arrangement. An entity measures the initial carrying amounts of the assets and liabilities by disaggregating them from the carrying amount of the investment at the beginning of the immediately preceding period on the basis of the information used by the entity in applying the equity method.**

39. **Any difference arising from the investment previously accounted for using the equity method together with any other items that formed part of the entity's net investment in the arrangement in accordance with paragraph 41 of IPSAS 36 and the net amount of the assets and liabilities, including any goodwill, recognized shall be:**

    (a) **Offset against any goodwill relating to the investment with any remaining difference adjusted against accumulated surplus or deficit at the beginning of the immediately preceding period, if the net amount of the assets and liabilities, including any goodwill, recognized is higher than the investment (and any other items that formed part of the entity's net investment) derecognized.**

    (b) **Adjusted against accumulated surplus or deficit at the beginning of the immediately preceding period, if the net amount of the assets and liabilities, including any goodwill, recognized is lower than the investment (and any other items that formed part of the entity's net investment) derecognized.**

40. **An entity changing from the equity method to accounting for assets and liabilities shall provide a reconciliation between the investment derecognized, and the assets and liabilities recognized, together with any remaining difference adjusted against accumulated surplus or deficit, at the beginning of the immediately preceding period.**

Transitional Provisions in an Entity's Separate Financial Statements

41. **An entity that, in accordance with paragraph 58 of IPSAS 6, *Consolidated and Separate Financial Statements,* was previously accounting in its separate financial statements for its interest in a joint operation as an investment using the equity method, at cost or in accordance with IPSAS 41 shall:**

    (a) **Derecognize the investment and recognize the assets and the liabilities in respect of its interest in the joint operation at the amounts determined in accordance with paragraphs 37–39.**

    (b) **Provide a reconciliation between the investment derecognized, and the assets and liabilities recognized, together with any remaining difference adjusted in accumulated surplus or deficit, at the beginning of the immediately preceding period.**

Accounting for acquisitions of interests in joint operations

41A. IPSAS 40, *Public Sector Combinations*, issued in January 2017, added paragraphs 24A, 42B, and AG33A–AG33D. An entity shall apply those amendments prospectively for acquisitions of interests in joint operations in which the activities of the joint operations constitute operations, as defined in IPSAS 40, for those acquisitions occurring from the beginning of the first period in which it applies those amendments. Consequently, amounts recognized for acquisitions of interests in joint operations occurring in prior periods shall not be adjusted.

Effective Date

42. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2017, it shall disclose that fact and apply IPSAS 34, IPSAS 35, IPSAS 36 and IPSAS 38, *Disclosure of Interests in Other Entities*, at the same time.**

42A. **Paragraphs 5 and 6 were deleted by *The Applicability of IPSASs*, issued in April 2016. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2018, it shall disclose that fact.**

42B. **Paragraphs 24A, 41A and AG33A–AG33D were added by IPSAS 40, *Public Sector Combinations*, issued in January 2017. An entity shall apply these amendments prospectively for annual financial statements covering periods beginning on or after January 1, 2019. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2019 it shall disclose that fact and apply IPSAS 40 at the same time.**

42C. **Paragraph 32 was amended by IPSAS 40, *Public Sector Combinations*, issued in January 2017. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2019. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2019 it shall disclose that fact and apply IPSAS 40 at the same time.**

42D. **Paragraphs 28, 30, 41, AG11 and AG33A were amended by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply IPSAS 41 at the same time.**

42E. **Paragraph AG33CA was added by *Improvements to IPSAS*, 2018, issued in October 2018. An entity shall apply this amendment to transactions in which it obtains joint control on or after the beginning of the first annual financial statements covering periods beginning on or after January 1, 2019. Earlier application is permitted. If an entity applies this amendment for a period beginning before January 1, 2019, it shall disclose that fact.**

43. When an entity adopts the accrual basis IPSASs as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards* (IPSASs), for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

Withdrawal and Replacement of IPSAS 8 (December 2006)

44. This Standard supersedes IPSAS 8, *Interests in Joint Ventures* (December 2006). IPSAS 8 remains applicable until IPSAS 37 is applied or becomes effective, whichever is earlier.

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 37.

AG1. The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying IPSAS 37.

Joint Arrangements

Binding Arrangement (paragraph 8)

AG2. Consistent with the definition of binding arrangements in this Standard, this discussion of binding arrangements is also relevant to enforceable arrangements created by legislative or executive authority.

AG3. When joint arrangements are structured through a separate vehicle (see paragraphs AG19–AG33), the binding arrangement, or some aspects of the binding arrangement, will in some cases be incorporated in the articles, charter or by-laws of the separate vehicle.

AG4. The binding arrangement sets out the terms upon which the parties participate in the activity that is the subject of the arrangement. The binding arrangement generally deals with such matters as:

(a) The purpose, activity and duration of the joint arrangement.

(b) How the members of the board of directors, or equivalent governing body, of the joint arrangement, are appointed.

(c) The decision-making process: the matters requiring decisions from the parties, the voting rights of the parties and the required level of support for those matters. The decision-making process reflected in the binding arrangement establishes joint control of the arrangement (see paragraphs AG5–AG11).

(d) The capital or other contributions required of the parties.

(e) How the parties share assets, liabilities, revenues, expenses or surplus or deficit relating to the joint arrangement.

Joint Control (paragraphs 12–18)

AG5. In assessing whether an entity has joint control of an arrangement, an entity shall assess first whether all the parties, or a group of the parties, control the arrangement. IPSAS 35, *Consolidated Financial Statements*, defines control and shall be used to determine whether all the parties, or a group of the parties, are exposed, or have rights, to variable benefits from their involvement with the arrangement and have the ability to affect those benefits through their power over the arrangement. When all the parties, or a group of the parties, considered collectively, are able to direct the activities that significantly affect the benefits from the arrangement (i.e., the relevant activities), the parties control the arrangement collectively.

AG6. After concluding that all the parties, or a group of the parties, control the arrangement collectively, an entity shall assess whether it has joint control of the arrangement. Joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that collectively control the arrangement. Assessing whether the arrangement is jointly controlled by all of its parties or by a group of the parties, or controlled by one of its parties alone, can require judgment.

AG7. Sometimes the decision-making process that is agreed upon by the parties in their binding arrangement implicitly leads to joint control. For example, assume two parties establish an arrangement in which each has 50 per cent of the voting rights and the binding arrangement between them specifies that at least 51 per cent of the voting rights are required to make decisions about the relevant activities. In this case, the parties have implicitly agreed that they have joint control of the arrangement because decisions about the relevant activities cannot be made without both parties agreeing.

AG8. In other circumstances, the binding arrangement requires a minimum proportion of the voting rights to make decisions about the relevant activities. When that minimum required proportion of the voting rights can be achieved by more than one combination of the parties agreeing together, that arrangement is not a joint arrangement unless the binding arrangement specifies which parties (or combination of parties) are required to agree unanimously to decisions about the relevant activities of the arrangement.

Application Examples

Example 1

Assume that three parties establish an arrangement: A has 50 per cent of the voting rights in the arrangement, B has 30 per cent and C has 20 per cent. The binding arrangement between A, B and C specifies that at least 75 per cent of the voting rights are required to make decisions about the relevant activities of the arrangement. Even though A can block any decision, it does not control the arrangement because it needs the agreement of B. The terms of their binding arrangement requiring at least 75 per cent of the voting rights to make decisions about the relevant activities imply that A and B have joint control of the arrangement because decisions about the relevant activities of the arrangement cannot be made without both A and B agreeing.

Example 2

Assume an arrangement has three parties: A has 50 per cent of the voting rights in the arrangement and B and C each have 25 per cent. The binding arrangement between A, B and C specifies that at least 75 per cent of the voting rights are required to make decisions about the relevant activities of the arrangement. Even though A can block any decision, it does not control the arrangement because it needs the agreement of either B or C. In this example, A, B and C collectively control the arrangement. However, there is more than one combination of parties that can agree to reach 75 per cent of the voting rights (i.e., either A and B or A and C). In such a situation, to be a joint arrangement the binding arrangement between the parties would need to specify which combination of the parties is required to agree unanimously to decisions about the relevant activities of the arrangement.

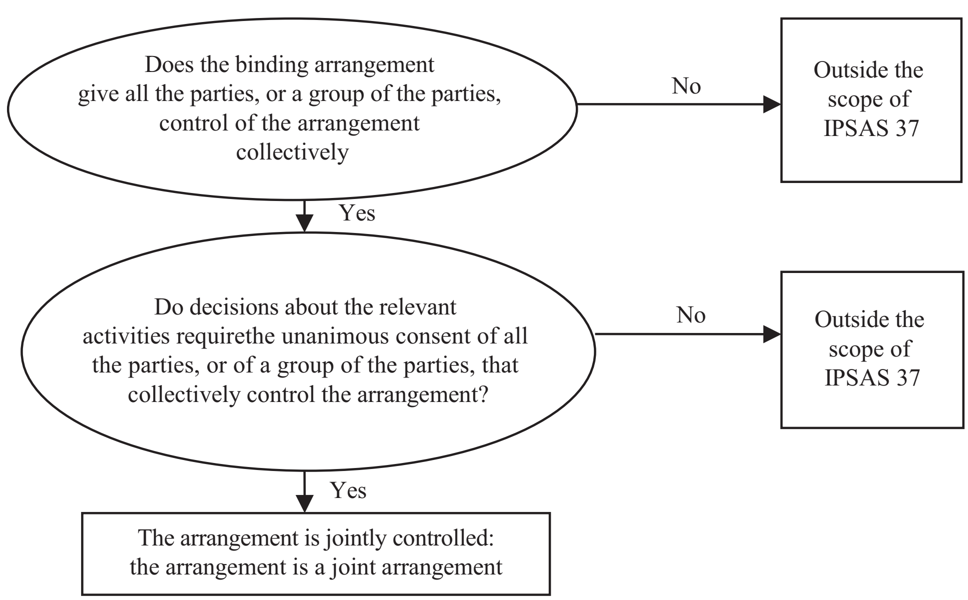
Example 3

Assume an arrangement in which A and B each have 35 per cent of the voting rights in the arrangement with the remaining 30 per cent being widely dispersed. Decisions about the relevant activities require approval by a majority of the voting rights. A and B have joint control of the arrangement only if the binding arrangement specifies that decisions about the relevant activities of the arrangement require both A and B agreeing.

AG9. The requirement for unanimous consent means that any party with joint control of the arrangement can prevent any of the other parties, or a group of the parties, from making unilateral decisions (about the relevant activities) without its consent. If the requirement for unanimous consent relates only to decisions that give a party protective rights and not to decisions about the relevant activities of an arrangement, that party is not a party with joint control of the arrangement.

AG10. A binding arrangement might include clauses on the resolution of disputes, such as arbitration. These provisions may allow for decisions to be made in the absence of unanimous consent among the parties that have joint control. The existence of such provisions does not prevent the arrangement from being jointly controlled and, consequently, from being a joint arrangement.

Assessing Joint Control



AG11. When an arrangement is outside the scope of IPSAS 37, *Joint Arrangements*, an entity accounts for its interest in the arrangement in accordance with relevant IPSASs, such as IPSAS 35, IPSAS 36, *Investments in Associates and Joint Ventures* or IPSAS 41, *Financial Instruments*.

Types of Joint Arrangement (paragraphs 19–22)

AG12. Joint arrangements are established for a variety of purposes (e.g., as a way for parties to share costs and risks, or as a way to provide the parties with access to new technology or new markets), and can be established using different structures and legal forms.

AG13. Some arrangements do not require the activity that is the subject of the arrangement to be undertaken in a separate vehicle. However, other arrangements involve the establishment of a separate vehicle.

AG14. The classification of joint arrangements required by this Standard depends upon the parties' rights and obligations arising from the arrangement in the normal course of operations. This Standard classifies joint arrangements as either joint operations or joint ventures. When an entity has rights to the assets, and obligations for the liabilities, relating to the arrangement, the arrangement is a joint operation. When an entity has rights to the net assets of the arrangement, the arrangement is a joint venture. Paragraphs AG16–AG33 set out the assessment an entity carries out to determine whether it has an interest in a joint operation or an interest in a joint venture.

Classification of a Joint Arrangement

AG15. As stated in paragraph AG14, the classification of joint arrangements requires the parties to assess their rights and obligations arising from the arrangement. When making that assessment, an entity shall consider the following:

(a) The structure of the joint arrangement (see paragraphs AG16–AG21).

(b) When the joint arrangement is structured through a separate vehicle:

  (i) The legal form of the separate vehicle (see paragraphs AG22–AG24);

  (ii) The terms of the binding arrangement (see paragraphs AG25–AG28); and

  (iii) When relevant, other facts and circumstances (see paragraphs AG29–AG33).

Structure of the Joint Arrangement

Joint Arrangements not Structured Through a Separate Vehicle

AG16. A joint arrangement that is not structured through a separate vehicle is a joint operation. In such cases, the binding arrangement establishes the parties' rights to the assets, and obligations for the liabilities, relating to the arrangement, and the parties' rights to the corresponding revenues and obligations for the corresponding expenses.

AG17. The binding arrangement often describes the nature of the activities that are the subject of the arrangement and how the parties intend to undertake those activities together. For example, the parties to a joint arrangement could agree to deliver services or manufacture a product together, with each party being responsible for specific areas and each using its own assets and incurring its own liabilities. The binding arrangement could also specify how the revenues and expenses that are common to the parties are to be shared among them. In such a case, each joint operator recognizes in its financial statements the assets and liabilities used for the specific task, and recognizes its share of the revenues and expenses in accordance with the binding arrangement.

AG18. In other cases, the parties to a joint arrangement might agree, for example, to share and operate an asset together. In such a case, the binding arrangement establishes the parties' rights to the asset that is operated jointly, and how output or revenue from the asset and operating costs are shared among the parties. Each joint operator accounts for its share of the joint asset and its agreed share of any liabilities, and recognizes its share of the output, revenues and expenses in accordance with the binding arrangement.

Joint Arrangements Structured through a Separate Vehicle

AG19. A joint arrangement in which the assets and liabilities relating to the arrangement are held in a separate vehicle can be either a joint venture or a joint operation.

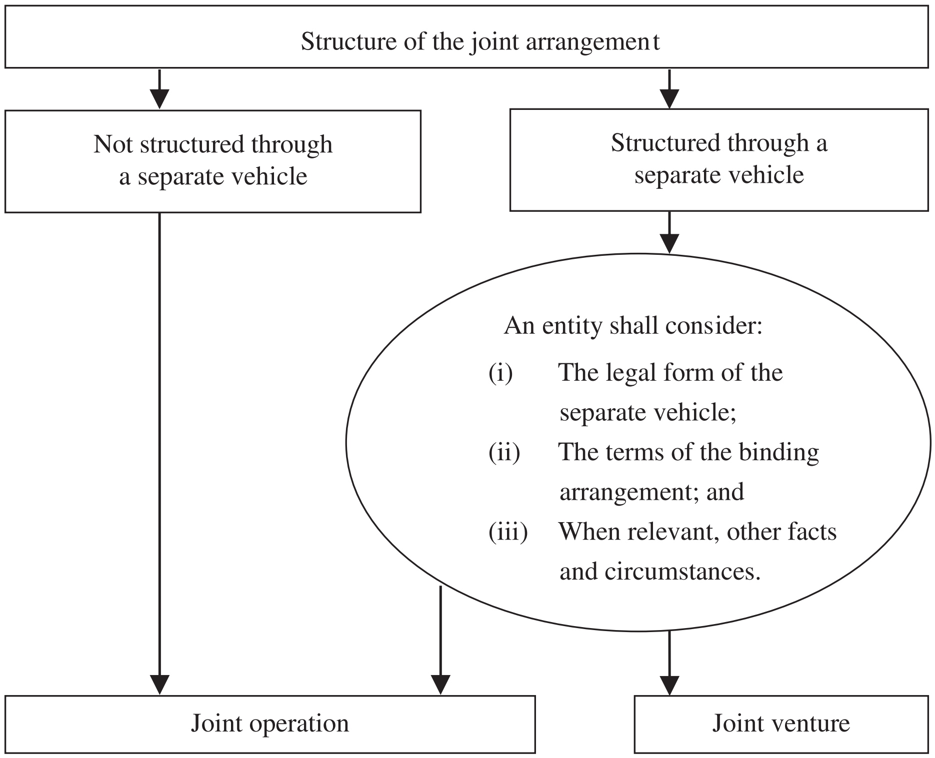
AG20. Whether a party is a joint operator or a joint venturer depends on the party's rights to the assets, and obligations for the liabilities, relating to the arrangement, that are held in the separate vehicle.

AG21. As stated in paragraph AG15, when the parties have structured a joint arrangement in a separate vehicle, the parties need to assess whether the legal form of the separate vehicle, the terms of the binding arrangement and, when relevant, any other facts and circumstances give them:

(a) Rights to the assets, and obligations for the liabilities, relating to the arrangement (i.e., the arrangement is a joint operation); or

(b) Rights to the net assets of the arrangement (i.e., the arrangement is a joint venture).

Classification of a Joint Arrangement: Assessment of the Parties' Rights and Obligations Arising from the Arrangement



The Legal Form of the Separate Vehicle

AG22. The legal form of the separate vehicle is relevant when assessing the type of joint arrangement. The legal form assists in the initial assessment of the parties' rights to the assets and obligations for the liabilities held in the separate vehicle, such as whether the parties have interests in the assets held in the separate vehicle and whether they are liable for the liabilities held in the separate vehicle.

AG23. For example, the parties might conduct the joint arrangement through a separate vehicle, whose legal form causes the separate vehicle to be considered in its own right (i.e., the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). In such a case, the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle indicates that the arrangement is a joint venture. However, the terms agreed by the parties in their binding arrangement (see paragraphs AG25–AG28) and, when relevant, other facts and circumstances (see paragraphs AG29–AG33) can override the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle.

AG24. The assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle is sufficient to conclude that the arrangement is a joint operation only if the parties conduct the joint arrangement in a separate vehicle whose legal form does not confer separation between the parties and the separate vehicle (i.e., the assets and liabilities held in the separate vehicle are the parties' assets and liabilities).

Assessing the Terms of the Binding Arrangement

AG25. In many cases, the rights and obligations agreed to by the parties in their binding arrangements are consistent, or do not conflict, with the rights and obligations conferred on the parties by the legal form of the separate vehicle in which the arrangement has been structured.

AG26. In other cases, the parties use the binding arrangement to reverse or modify the rights and obligations conferred by the legal form of the separate vehicle in which the arrangement has been structured.

Application Example
Example 4 Assume that two parties structure a joint arrangement in an incorporated entity. Each party has a 50 per cent ownership interest in the incorporated entity. The incorporation enables the separation of the entity from its owners and as a consequence the assets and liabilities held in the entity are the assets and liabilities of the incorporated entity. In such a case, the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle indicates that the parties have rights to the net assets of the arrangement. However, the parties modify the features of the corporation through their binding arrangement so that each has an interest in the assets of the incorporated entity and each is liable for the liabilities of the incorporated entity in a specified proportion. Such binding modifications to the features of a corporation can cause an arrangement to be a joint operation.

AG27. The following table compares common terms in binding arrangements of parties to a joint operation and common terms in binding arrangements of parties to a joint venture. The examples of the binding terms provided in the following table are not exhaustive.

Assessing the Terms of the Binding Arrangement		
	Joint Operation	**Joint Venture**
The terms of the binding arrangement	The binding arrangement provides the parties to the joint arrangement with rights to the assets, and obligations for the liabilities, relating to the arrangement.	The binding arrangement provides the parties to the joint arrangement with rights to the net assets of the arrangement (i.e., it is the separate vehicle, not the parties, that has rights to the assets, and obligations for the liabilities, relating to the arrangement).
Rights to assets	The binding arrangement establishes that the parties to the joint arrangement share all interests (e.g., rights, title or ownership) in the assets relating to the arrangement in a specified proportion (e.g., in proportion to the parties' ownership interest in the arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them).	The binding arrangement establishes that the assets brought into the arrangement or subsequently acquired by the joint arrangement are the arrangement's assets. The parties have no interests (i.e., no rights, title or ownership) in the assets of the arrangement.
Obligations for liabilities	The binding arrangement establishes that the parties to the joint arrangement share all liabilities, obligations, costs and expenses in a specified proportion (e.g., in proportion to the parties' ownership interest in the arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them).	The binding arrangement establishes that the joint arrangement is liable for the debts and obligations of the arrangement.
		The binding arrangement establishes that the parties to the joint arrangement are liable to the arrangement only to the extent of their respective investments in the arrangement or to their respective obligations to contribute any unpaid or additional capital to the arrangement, or both.

Assessing the Terms of the Binding Arrangement		
	Joint Operation	**Joint Venture**
	The binding arrangement establishes that the parties to the joint arrangement are liable for claims raised by third parties.	The binding arrangement states that creditors of the joint arrangement do not have rights of recourse against any party with respect to debts or obligations of the arrangement.
Revenues, expenses, surplus or deficit	The binding arrangement establishes the allocation of revenues and expenses on the basis of the relative performance of each party to the joint arrangement. For example, the binding arrangement might establish that revenues and expenses are allocated on the basis of the capacity that each party uses in a plant operated jointly, which could differ from their ownership interest in the joint arrangement. In other instances, the parties might have agreed to share the surplus or deficit relating to the arrangement on the basis of a specified proportion such as the parties' ownership interest in the arrangement. This would not prevent the arrangement from being a joint operation if the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement.	The binding arrangement establishes each party's share in the surplus or deficit relating to the activities of the arrangement.
Guarantees	The parties to joint arrangements are often required to provide guarantees to third parties that, for example, receive a service from, or provide financing to, the joint arrangement. The provision of such guarantees, or the commitment by the parties to provide them, does not, by itself, determine that the joint arrangement is a joint operation. The feature that determines whether the joint arrangement is a joint operation or a joint venture is whether the parties have obligations for the liabilities relating to the arrangement (for some of which the parties might or might not have provided a guarantee).	

AG28. When the binding arrangement specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement, they are parties to a joint operation and do not need to consider other facts and circumstances (paragraphs AG29–AG33) for the purposes of classifying the joint arrangement.

Assessing Other Facts and Circumstances

AG29. When the terms of the binding arrangement do not specify that the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement, the parties shall consider other facts and circumstances to assess whether the arrangement is a joint operation or a joint venture.

AG30. A joint arrangement might be structured in a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The binding terms agreed among the parties might not specify the parties' rights to the assets and obligations for the liabilities, yet consideration of other facts and circumstances can lead to such an arrangement being classified as a joint operation. This will be the case when other facts and circumstances give the parties rights to the assets, and obligations for the liabilities, relating to the arrangement.

AG31. When the activities of an arrangement are primarily designed for the provision of output to the parties, this indicates that the parties have rights to substantially all the service potential or economic benefits of the assets of the arrangement. The parties to such arrangements often ensure their access to the outputs provided by the arrangement by preventing the arrangement from selling output to third parties.

AG32. The effect of an arrangement with such a design and purpose is that the liabilities incurred by the arrangement are, in substance, satisfied by the cash flows received from the parties through their purchases of the output. When the parties are substantially the only source of cash flows contributing to the continuity of the operations of the arrangement, this indicates that the parties have an obligation for the liabilities relating to the arrangement.

Application Example

Example 5

Assume that two parties structure a joint arrangement in an incorporated entity (entity C) in which each party has a 50 per cent ownership interest. The purpose of the arrangement is to manufacture materials required by the parties for their own, individual manufacturing processes. The arrangement ensures that the parties operate the facility that produces the materials to the quantity and quality specifications of the parties.

The legal form of entity C (an incorporated entity) through which the activities are conducted initially indicates that the assets and liabilities held in entity C are the assets and liabilities of entity C. The binding arrangement between the parties does not specify that the parties have rights to the assets or obligations for the liabilities of entity C. Accordingly, the legal form of entity C and the terms of the binding arrangement indicate that the arrangement is a joint venture.

However, the parties also consider the following aspects of the arrangement:

- The parties agreed to purchase all the output produced by entity C in a ratio of 50:50. Entity C cannot sell any of the output to third parties, unless this is approved by the two parties to the arrangement. Because the purpose of the arrangement is to provide the parties with output they require, such sales to third parties are expected to be uncommon and not material.
- The price of the output sold to the parties is set by both parties at a level that is designed to cover the costs of production and administrative expenses incurred by entity C. On the basis of this operating model, the arrangement is intended to operate at a break-even level.

From the fact pattern above, the following facts and circumstances are relevant:

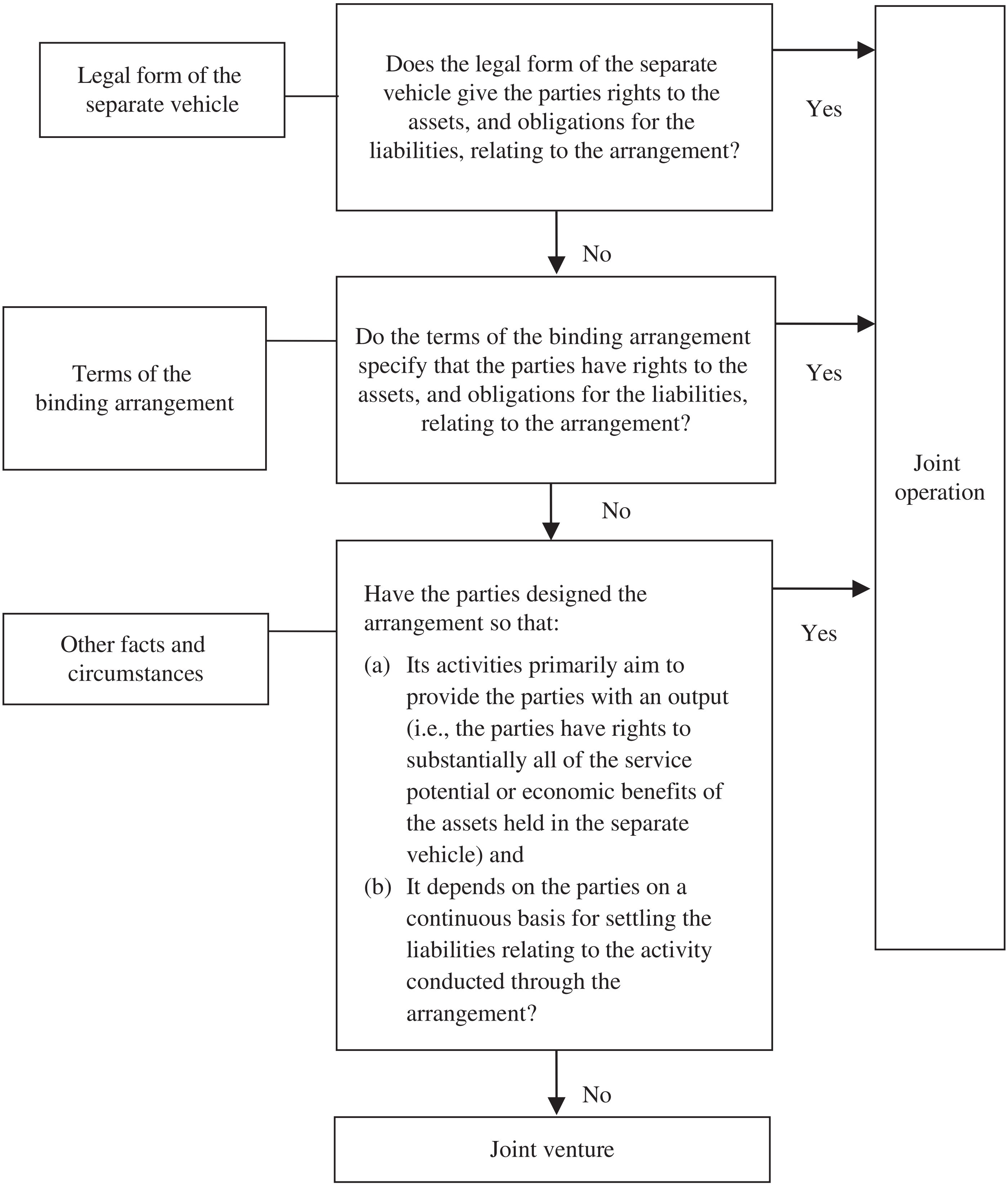
- The obligation of the parties to purchase all the output produced by entity C reflects the exclusive dependence of entity C upon the parties for the generation of cash flows and, thus, the parties have an obligation to fund the settlement of the liabilities of entity C.
- The fact that the parties have rights to all the output produced by entity C means that the parties are consuming, and therefore have rights to, all the service potential or economic benefits of the assets of entity C.

These facts and circumstances indicate that the arrangement is a joint operation. The conclusion about the classification of the joint arrangement in these circumstances would not change if, instead of the parties using their share of the output themselves in a subsequent manufacturing process, the parties sold their share of the output to third parties.

If the parties changed the terms of the binding arrangement so that the arrangement was able to sell output to third parties, this would result in entity C assuming demand, inventory and credit risks. In that scenario, such a change in the facts and circumstances would require reassessment of the classification of the joint arrangement. Such facts and circumstances would indicate that the arrangement is a joint venture.

AG33. The following flow chart reflects the assessment an entity follows to classify an arrangement when the joint arrangement is structured through a separate vehicle:

Classification of a Joint Arrangement Structured Through a Separate Vehicle



Financial Statements of Parties to a Joint Arrangement (paragraphs 23–28)

Accounting for Acquisitions of Interests in Joint Operations

AG33A. When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes an operation, as defined in IPSAS 40, it shall apply, to the extent of its share in accordance with paragraph 23, all of the principles on acquisition accounting in IPSAS 40, and other IPSASs, that do not conflict with the guidance in this Standard and disclose the information required by those IPSASs in relation to acquisitions. The principles on acquisition accounting that do not conflict with the guidance in this Standard include but are not limited to:

(a) Measuring identifiable assets and liabilities at fair value, other than items for which exceptions are given in IPSAS 40 and other IPSASs;

(b) Recognizing acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with the exception that the costs to issue debt or equity securities are recognized in accordance with IPSAS 28 and IPSAS 41;

(c) Recognizing the excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, if any, as goodwill; and

(d) Testing for impairment a cash-generating unit to which goodwill has been allocated at least annually, and whenever there is an indication that the unit may be impaired, as required by IPSAS 26, *Impairment of Cash-Generating Assets*, for goodwill acquired in an acquisition.

AG33B. Paragraphs 24A and AG33A also apply to the formation of a joint operation if, and only if, an existing operation, as defined in IPSAS 40, is contributed to the joint operation on its formation by one of the parties that participate in the joint operation. However, those paragraphs do not apply to the formation of a joint operation if all of the parties that participate in the joint operation only contribute assets or groups of assets that do not constitute operations to the joint operation on its formation.

AG33C. A joint operator might increase its interest in a joint operation in which the activity of the joint operation constitutes an operation, as defined in IPSAS 40, by acquiring an additional interest in the joint operation. In such cases, previously held interests in the joint operation are not remeasured if the joint operator retains joint control.

AG33CA. A party that participates in, but does not have joint control of, a joint operation might obtain joint control of the joint operation in which the activity of the joint operation constitutes an operation as defined in IPSAS 40. In such cases, previously held interests in the joint operation are not remeasured.

AG33D. Paragraphs 24A and AG33A–AG33C do not apply on the acquisition of an interest in a joint operation when the parties sharing joint control, including the entity acquiring the interest in the joint operation, are under the common control of the same ultimate controlling party or parties both before and after the acquisition, and that control is not transitory.

Accounting for Sales or Contributions of Assets to a Joint Operation

AG34. When an entity enters into a transaction with a joint operation in which it is a joint operator, such as a sale or contribution of assets, it is conducting the transaction with the other parties to the joint operation and, as such, the joint operator shall recognize gains and losses resulting from such a transaction only to the extent of the other parties' interests in the joint operation.

AG35. When such transactions provide evidence of a reduction in the net realizable value of the assets to be sold or contributed to the joint operation, or of an impairment loss of those assets, those losses shall be recognized fully by the joint operator.

Accounting for Purchases of Assets from a Joint Operation

AG36. When an entity enters into a transaction with a joint operation in which it is a joint operator, such as a purchase of assets, it shall not recognize its share of the gains and losses until it resells those assets to a third party.

AG37. When such transactions provide evidence of a reduction in the net realizable value of the assets to be purchased or of an impairment loss of those assets, a joint operator shall recognize its share of those losses.

Appendix B

Amendments to Other IPSASs

[Deleted]

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 37.

Objective

BC1. This Basis for Conclusions summarizes the IPSASB's considerations in reaching the conclusions in IPSAS 37. As this Standard is based on IFRS 11, *Joint Arrangements* (issued in 2011, including amendments up to December 31, 2014), issued by the IASB, the Basis for Conclusions outlines only those areas where IPSAS 37 departs from the main requirements of IFRS 11.

Overview

BC2. In 2012 the IPSASB commenced work on a project to update those IPSASs that dealt with accounting for interests in controlled entities, associates and joint ventures. In October 2013 the IPSASB issued Exposure Drafts (EDs) 48 to 52 which were collectively referred to as *Interests in Other Entities*. ED 51, *Joint Arrangements*, was based on IFRS 11, *Joint Arrangements*, having regard to the relevant public sector modifications in IPSAS 8, *Interests in Joint Ventures*. In January 2015 the IPSASB issued five new IPSASs, including IPSAS 37. These new IPSASs supersede IPSAS 6, *Consolidated and Separate Financial Statements*, IPSAS 7, *Investments in Associates* and IPSAS 8.

Classification of Joint Arrangements

BC3. IPSAS 37 classifies joint arrangements as joint ventures or joint operations based on whether an entity has (i) rights to assets and obligations for liabilities, or (ii) rights to net assets. This differs from IPSAS 8 which referred to three types of arrangements, being jointly controlled entities, jointly controlled operations and jointly controlled assets. The IPSASB agreed that the classification of joint arrangements in IPSAS 37 should be consistent with IFRS 11.

Elimination of Accounting Option

BC4. IPSAS 37 requires that a joint venturer account for its interest in a joint venture using the equity method. Previously IPSAS 8 permitted jointly controlled entities to be accounted for using either the equity method or proportionate consolidation. The IPSASB acknowledged the IASB's rationale for removing proportionate consolidation as a method for accounting for interests in joint ventures and agreed that the accounting treatments permitted by IPSAS 37 should be consistent with IFRS 11.

BC5. The IASB's reasons for removing proportionate consolidation as a method for accounting for interests in joint ventures included the following:

(a) The equity method is the most appropriate method to account for joint ventures because it is a method that accounts for an entity's interest in the net assets of an investee.

(b) The approach in IFRS 11 is consistent with the IASB's view of what constitutes the economic substance of an entity's interests in joint arrangements.

(c) IFRS 11 will require consistent accounting for arrangements with similar rights.

(d) The IASB did not consider that the elimination of proportionate consolidation would cause a loss of information for users of financial statements (having regard to the disclosure requirements in IFRS 12, *Disclosure of Interests in Other Entities*).

BC6. The IPSASB took the view there were no public sector differences that warranted a different approach to that taken by the IASB.

Acquisition of an Interest in a Joint Operation

BC7. At the time that IPSAS 37 was being developed, the IASB sought feedback on proposals to amend IFRS 11 by adding new guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business, as defined in IFRS 3, *Business Combinations*. The IASB issued *Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11)* in May 2014. The IPSASB agreed not to incorporate such guidance in IPSAS 37 on the grounds that it would be more appropriate to consider such guidance in the context of drafting standards-level requirements for public sector combinations.

BC8. At the time the IPSASB developed IPSAS 40, *Public Sector Combinations*, it reconsidered whether to include guidance on how to account for the acquisition of an interest in a joint operation that constitutes an operation. The IPSASB reviewed the guidance issued by the IASB in Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11) and did not identify a public sector reason to depart from that guidance. Consequently, the IPSASB agreed to include this guidance (amended to fit the terminology and definitions in IPSAS 40) in IPSAS 37.

Revision of IPSAS 37 as a result of the IPSASB's *The Applicability of IPSASs*, issued in April 2016

BC9. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:

(a) Removes the standard paragraphs about the applicability of IPSASs to "public sector entities other than GBEs" from the scope section of each Standard;

(b) Replaces the term "GBE" with the term "commercial public sector entities", where appropriate; and

(c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.

Revision of IPSAS 37 as a result of *Improvements to IPSAS, 2018*

BC10. The IPSASB reviewed the revisions to IFRS 11, *Joint Arrangements*, included in *Annual Improvements to IFRS® Standards 2015–2017 Cycle* issued by the IASB in December 2017, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions, and generally concurred that there was no public sector specific reason for not adopting the amendments.

ILLUSTRATIVE EXAMPLES

CONTENTS

Illustrative Examples

These examples accompany, but are not part of, IPSAS 37.

IE1. These examples portray hypothetical situations illustrating the judgments that might be used when applying IPSAS 37 in different situations. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying IPSAS 37.

Example 1 – Construction Services

IE2. A and B (the parties) are two entities whose activities include the provision of many types of public and private construction services. Entity A is a private sector entity. Entity B is government owned. They set up a binding arrangement to work together for the purpose of fulfilling a contract with a government for the design and construction of a road between two cities. The binding arrangement determines the participation shares of A and B and establishes joint control of the arrangement, the subject matter of which is the delivery of the road. The joint arrangement will have no further involvement once the road has been completed. The road will be transferred to the government at that point.

IE3. The parties set up a separate vehicle (entity Z) through which to conduct the arrangement. Entity Z, on behalf of A and B, enters into the contract with the government. In addition, the assets and liabilities relating to the arrangement are held in entity Z. The main feature of entity Z's legal form is that the parties, not entity Z, have rights to the assets, and obligations for the liabilities, of the entity.

IE4. The binding arrangement between A and B additionally establishes that:

(a) The rights to all the assets needed to undertake the activities of the arrangement are shared by the parties on the basis of their participation shares in the arrangement;

(b) The parties have several and joint responsibility for all operating and financial obligations relating to the activities of the arrangement on the basis of their participation shares in the arrangement; and

(c) The surplus or deficit resulting from the activities of the arrangement is shared by A and B on the basis of their participation shares in the arrangement.

IE5. For the purposes of co-ordinating and overseeing the activities, A and B appoint a project manager, who will be an employee of one of the parties. After a specified time, the role of the project manager will rotate to an employee of the other party. A and B agree that the activities will be executed by the employees on a "no gain or loss" basis.

IE6. In accordance with the terms specified in the contract with the government, entity Z invoices the construction services to the government on behalf of the parties.

Analysis

IE7. The joint arrangement is carried out through a separate vehicle whose legal form does not confer separation between the parties and the separate vehicle (i.e., the assets and liabilities held in entity Z are the parties' assets and liabilities). This is reinforced by the terms agreed by the parties in their binding arrangement, which state that A and B have rights to the assets, and obligations for the liabilities, relating to the arrangement that is conducted through entity Z. The joint arrangement is a joint operation. It is not a service concession arrangement.

IE8. A and B each recognize in their financial statements their share of the assets (e.g., property, plant, and equipment, accounts receivable) and their share of any liabilities resulting from the arrangement (e.g., accounts payable to third parties) on the basis of their agreed participation share. Each also recognizes its share of the revenue and expenses resulting from the construction services provided to the government through entity Z.

Example 2 – Service Centre Operated Jointly

IE9. Two entities (the parties) set up a separate vehicle (entity X) for the purpose of establishing and operating a joint service center. The binding arrangement between the parties establishes joint control of the activities that are conducted in entity X. The main feature of entity X's legal form is that the entity, not the parties, has rights to the assets, and obligations for the liabilities, relating to the arrangement. These activities include the allocation of office space to services, managing the car park, maintaining the center and its equipment, such as lifts, building the reputation of the center and managing the client base for the center.

IE10. The terms of the binding arrangement are such that:

(a) Entity X owns the service center. The binding arrangement does not specify that the parties have rights to the service center.

(b) The parties are not liable in respect of the debts, liabilities or obligations of entity X. If entity X is unable to pay any of its debts or other liabilities or to discharge its obligations to third parties, the liability of each party to any third party will be limited to the unpaid amount of that party's capital contribution.

(c) The parties have the right to sell or pledge their interests in entity X.

(d) Each party pays for its share of expenses for operating the service in accordance with its interest in entity X.

Analysis

IE11. The joint arrangement is carried out through a separate vehicle whose legal form causes the separate vehicle to be considered in its own right (i.e., the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). In addition, the terms of the binding arrangement do not specify that the parties have rights to the assets, or obligations for the liabilities, relating to the arrangement. Instead, the terms of the binding arrangement establish that the parties have rights to the net assets of entity X.

IE12. On the basis of the description above, there are no other facts and circumstances that indicate that the parties have rights to substantially all the service potential or economic benefits of the assets relating to the arrangement, and that the parties have an obligation for the liabilities relating to the arrangement. The joint arrangement is a joint venture.

IE13. The parties recognize their rights to the net assets of entity X as investments and account for them using the equity method.

Example 3 – Joint Provision of Assisted Living Services

IE14. A public sector health care provider (entity X) and a large property developer (entity Y) enter into an agreement to work together to provide assisted living services for the elderly. Entity X and entity Y establish a separate company (entity Z). The legal form of the company confers the rights to the assets and obligations for liabilities to the company itself. The agreement between entity X and entity Y requires all decisions be made jointly. The agreement also confirms:

(a) Entity X will provide the assisted living services. Entity Y will construct the premises.

(b) The assets of the arrangement are owned by entity Z, the company. Neither party will be able to sell, pledge, transfer or otherwise mortgage the assets of entity Z.

(c) The liability of the parties is limited to any unpaid capital of entity Z.

(d) Each party pays for its share of expenses for operating the service in accordance with its interest in entity Z.

(e) Profits of entity Z will be distributed to entity X and entity Y 40:60, being the parties' respective interests in the arrangement.

Analysis

IE15. The joint arrangement is carried out through a separate vehicle whose legal form causes the separate vehicle to be considered in its own right (i.e., the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). In addition, the terms of the binding arrangement do not specify that the parties have rights to the assets, or obligations for the liabilities, relating to the arrangement. Instead, the terms of the binding arrangement establish that the parties have rights to the net assets of entity Z.

IE16. On the basis of the description above, there are no other facts and circumstances that indicate that the parties have rights to substantially all the service potential or economic benefits of the assets relating to the arrangement, or that the parties have an obligation for the liabilities relating to the arrangement. The joint arrangement is a joint venture.

IE17. The parties recognize their rights to the net assets of entity Z as investments and account for them using the equity method.

Variation

IE18. A public sector health care provider (entity X) and a large property developer (entity Y) enter into an agreement to work together to provide assisted living services for the elderly. The agreement between entity X and entity Y requires all decisions to be made jointly. The agreement confirms:

(a) Entity X will supply operational assets including office equipment, motor vehicles and furniture and fittings for the assisted living premises.

(b) Entity Y will construct the premises and will continue to own the premises. Entity Y will be responsible for the ongoing maintenance of the premises. Entity Y cannot sell the premises without first offering entity X the right to purchase the premises. Entity Y is entitled to 100% of any gain on eventual sale of the premises.

(c) The services will be delivered through a new entity, entity Z, established for this purpose.

(d) Each party will pay for 50% of the expenses for operating the services.

(e) Any profits from providing the assisted living services will be shared equally between entity X and entity Y.

(f) Entity X will be responsible for managing staff and for any liabilities arising from personal grievance claims and health and safety issues.

(g) Entity Y will be responsible for any liabilities to make good any defects in the premises or alterations to the premises required to meet health and safety codes and changes in those codes.

Analysis of Variation

IE19. Although the services are delivered through a separate vehicle, entity X and entity Y continue to own the assets used to provide the services. The joint arrangement is a joint operation.

IE20. Entity X and entity Y each recognize in their financial statements their own assets and liabilities. They also recognize their share of the revenue and expenses resulting from the provision of assisted living services through entity Z.

Example 4 – Joint Manufacturing and Distribution of a Product

IE21. Entities A and B (the parties) have set up a strategic and operating agreement (the framework agreement) in which they have agreed the terms according to which they will conduct the manufacturing and distribution of a product (product P) in different markets.

IE22. The parties have agreed to conduct manufacturing and distribution activities by establishing joint arrangements, as described below:

(a) Manufacturing activity: the parties have agreed to undertake the manufacturing activity through a joint arrangement (the manufacturing arrangement). The manufacturing arrangement is structured in a separate vehicle (entity M) whose legal form causes it to be considered in its own right (i.e., the assets and liabilities held in entity M are the assets and liabilities of entity M and not the assets and liabilities of the parties). In accordance with the framework agreement, the parties have committed themselves to purchasing the whole production of product P manufactured by the manufacturing arrangement in accordance with their ownership interests in entity M. The parties subsequently sell product P to another arrangement, jointly controlled by the two parties themselves, that has been established exclusively for the distribution of product P as described below. Neither the framework agreement nor the binding arrangement between A and B dealing with the manufacturing activity specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the manufacturing activity.

(b) Distribution activity: the parties have agreed to undertake the distribution activity through a joint arrangement (the distribution arrangement). The parties have structured the distribution arrangement in a separate vehicle (entity D) whose legal form causes it to be considered in its own right (i.e., the assets and liabilities held in entity D are the assets and liabilities of entity D and not the assets and liabilities of the parties). In accordance with the framework agreement, the distribution arrangement orders its requirements for product P from the parties according to the needs of the different markets where the distribution arrangement sells the product. Neither the framework agreement nor the binding arrangement between A and B dealing with the distribution activity specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the distribution activity.

IE23. In addition, the framework agreement establishes:

(a) That the manufacturing arrangement will produce product P to meet the requirements for product P that the distribution arrangement places on the parties;

(b) The commercial terms relating to the sale of product P by the manufacturing arrangement to the parties. The manufacturing arrangement will sell product P to the parties at a price agreed by A and B that covers all production costs incurred. Subsequently, the parties sell the product to the distribution arrangement at a price agreed by A and B.

(c) That any cash shortages that the manufacturing arrangement may incur will be financed by the parties in accordance with their ownership interests in entity M.

Analysis

IE24. The framework agreement sets up the terms under which parties A and B conduct the manufacturing and distribution of product P. These activities are undertaken through joint arrangements whose purpose is either the manufacturing or the distribution of product P.

IE25. The parties carry out the manufacturing arrangement through entity M whose legal form confers separation between the parties and the entity. In addition, neither the framework agreement nor the binding arrangement dealing with the manufacturing activity specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the manufacturing activity. However, when considering the following facts and circumstances the parties have concluded that the manufacturing arrangement is a joint operation:

(a) The parties have committed themselves to purchasing the whole production of product P manufactured by the manufacturing arrangement. Consequently, A and B have rights to substantially all the service potential or economic benefits of the assets of the manufacturing arrangement.

(b) The manufacturing arrangement manufactures product P to meet the quantity and quality needs of the parties so that they can fulfill the demand for product P of the distribution arrangement. The exclusive dependence of the manufacturing arrangement upon the parties for the generation of cash flows and the parties' commitments to provide funds when the manufacturing arrangement incurs any cash shortages indicate that the parties have an obligation for the liabilities of the manufacturing arrangement, because those liabilities will be settled through the parties' purchases of product P or by the parties' direct provision of funds.

IE26. The parties carry out the distribution activities through entity D, whose legal form confers separation between the parties and the entity. In addition, neither the framework agreement nor the binding arrangement dealing with the distribution activity specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the distribution activity.

IE27. There are no other facts and circumstances that indicate that the parties have rights to substantially all the service potential or economic benefits of the assets relating to the distribution arrangement or that the parties have an obligation for the liabilities relating to that arrangement. The distribution arrangement is a joint venture.

IE28. A and B each recognize in their financial statements their share of the assets (e.g., property, plant and equipment, cash) and their share of any liabilities resulting from the manufacturing arrangement (e.g., accounts payable to third parties) on the basis of their ownership interest in entity M. Each party also recognizes its share of the expenses resulting from the manufacture of product P incurred by the manufacturing arrangement and its share of the revenues relating to the sales of product P to the distribution arrangement.

IE29. The parties recognize their rights to the net assets of the distribution arrangement as investments and account for them using the equity method.

Variation

IE30. Assume that the parties agree that the manufacturing arrangement described above is responsible not only for manufacturing product P, but also for its distribution to third-party customers.

IE31. The parties also agree to set up a distribution arrangement like the one described above to distribute product P exclusively to assist in widening the distribution of product P in additional specific markets.

IE32. The manufacturing arrangement also sells product P directly to the distribution arrangement. No fixed proportion of the production of the manufacturing arrangement is committed to be purchased by, or to be reserved to, the distribution arrangement.

Analysis of Variation

IE33. The variation has affected neither the legal form of the separate vehicle in which the manufacturing activity is conducted nor the binding terms relating to the parties' rights to the assets, and obligations for the liabilities, relating to the manufacturing activity. However, it causes the manufacturing arrangement to be a self-financed arrangement because it is able to undertake trade on its own behalf, distributing product P to third-party customers and, consequently, assuming demand, inventory and credit risks. Even though the manufacturing arrangement might also sell product P to the distribution arrangement, in this scenario the manufacturing arrangement is not dependent on the parties to be able to carry out its activities on a continuous basis. In this case, the manufacturing arrangement is a joint venture.

IE34. The variation has no effect on the classification of the distribution arrangement as a joint venture.

IE35. The parties recognize their rights to the net assets of the manufacturing arrangement and their rights to the net assets of the distribution arrangement as investments and account for them using the equity method.

Example 5 – Bank Operated Jointly

IE36. Bank A, a government owned bank, and bank B, a privately owned bank, (the parties) agreed to combine certain corporate, investment banking, asset management and service activities by establishing a separate vehicle (bank C). Both parties expect the arrangement to benefit them in different ways. Bank A believes that the arrangement could enable it to achieve its strategic plans to improve its profitability through an enlarged offering of products and services. Bank B expects the arrangement to reinforce its offering in financial savings and market products.

IE37. The main feature of bank C's legal form is that it causes the separate vehicle to be considered in its own right (i.e., the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). Banks A and B each have a 40 per cent ownership interest in bank C, with the remaining 20 per cent being listed and widely held. The agreement between bank A and bank B establishes joint control of the activities of bank C.

IE38. In addition, bank A and bank B entered into an irrevocable agreement under which, even in the event of a dispute, both banks agree to provide the necessary funds in equal amount and, if required, jointly and severally, to ensure that bank C complies with the applicable legislation and banking regulations, and honors any commitments made to the banking authorities. This commitment represents the assumption by each party of 50 per cent of any funds needed to ensure that bank C complies with legislation and banking regulations.

Analysis

IE39. The joint arrangement is carried out through a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The terms of the binding arrangement do not specify that the parties have rights to the assets, or obligations for the liabilities, of bank C, but it establishes that the parties have rights to the net assets of bank C. The commitment by the parties to provide support if bank C is not able to comply with the applicable legislation and banking regulations is not by itself a determinant that the parties have an obligation for the liabilities of bank C. There are no other facts and circumstances that indicate that the parties have rights to substantially all the economic benefits of the assets of bank C and that the parties have an obligation for the liabilities of bank C. The joint arrangement is a joint venture.

IE40. Both banks A and B recognize their rights to the net assets of bank C as investments and account for them using the equity method.

Example 6 – Oil and Gas Exploration, Development and Production Activities

IE41. Entities A and B (the parties) set up a separate vehicle (entity H) and a Joint Operating Agreement (JOA) to undertake oil and gas exploration, development and production activities in country O. The main feature of entity H's legal form is that it causes the separate vehicle to be considered in its own right (i.e., the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties).

IE42. Country O has granted entity H permits for the oil and gas exploration, development and production activities to be undertaken in a specific assigned block of land (fields).

IE43. The agreement and JOA agreed by the parties establish their rights and obligations relating to those activities. The main terms of those agreements are summarized below.

Agreement

IE44. The board of entity H consists of a director from each party. Each party has a 50 per cent holding in entity H. The unanimous consent of the directors is required for any resolution to be passed.

Joint Operating Agreement (JOA)

IE45. The JOA establishes an Operating Committee. This Committee consists of one representative from each party. Each party has a 50 per cent participating interest in the Operating Committee.

IE46. The Operating Committee approves the budgets and work programs relating to the activities, which also require the unanimous consent of the representatives of each party. One of the parties is appointed as operator and is responsible for managing and conducting the approved work programs.

IE47. The JOA specifies that the rights and obligations arising from the exploration, development and production activities shall be shared among the parties in proportion to each party's holding in entity H. In particular, the JOA establishes that the parties share:

(a) The rights and the obligations arising from the exploration and development permits granted to entity H (e.g., the permits, rehabilitation liabilities, any royalties and taxes payable);

(b) The production obtained; and

(c) All costs associated with all work programs.

IE48. The costs incurred in relation to all the work programs are covered by cash calls on the parties. If either party fails to satisfy its monetary obligations, the other is required to contribute to entity H the amount in default. The amount in default is regarded as a debt owed by the defaulting party to the other party.

Analysis

IE49. The parties carry out the joint arrangement through a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The parties have been able to reverse the initial assessment of their rights and obligations arising from the legal form of the separate vehicle in which the arrangement is conducted. They have done this by agreeing terms in the JOA that entitle them to rights to the assets (e.g., exploration and development permits, production, and any other assets arising from the activities) and obligations for the liabilities (e.g., all costs and obligations arising from the work programs) that are held in entity H. The joint arrangement is a joint operation.

IE50. Both entity A and entity B recognize in their financial statements their own share of the assets and of any liabilities resulting from the arrangement on the basis of their agreed participating interest. On that basis, each party also recognizes its share of the revenue (from the sale of their share of the production) and its share of the expenses.

Example 7 – Liquefied Natural Gas Arrangement

IE51. Entity A owns an undeveloped gas field that contains substantial gas resources. Entity A determines that the gas field will be economically viable only if the gas is sold to customers in overseas markets. To do so, a liquefied natural gas (LNG) facility must be built to liquefy the gas so that it can be transported by ship to the overseas markets.

IE52. Entity A enters into a joint arrangement with entity B in order to develop and operate the gas field and the LNG facility. Under that arrangement, entities A and B (the parties) agree to contribute the gas field and cash, respectively, to a new separate vehicle, entity C. In exchange for those contributions, the parties each take a 50 per cent ownership interest in entity C. The main feature of entity C's legal form is that it causes the separate vehicle to be considered in its own right (i.e., the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties).

IE53. The binding arrangement between the parties specifies that:

(a) Entities A and B must each appoint two members to the board of entity C. The board of directors must unanimously agree the strategy and investments made by entity C.

(b) Day-to-day management of the gas field and LNG facility, including development and construction activities, will be undertaken by the staff of entity B in accordance with the directions jointly agreed by the parties. Entity C will reimburse B for the costs it incurs in managing the gas field and LNG facility.

(c) Entity C is liable for taxes and royalties on the production and sale of LNG as well as for other liabilities incurred in the ordinary course of business, such as accounts payable, site restoration and decommissioning liabilities.

(d) Entities A and B have equal shares in the surplus from the activities carried out in the arrangement and, as such, are entitled to equal shares of any dividends or similar distributions made by entity C.

IE54. The binding arrangement does not specify that either party has rights to the assets, or obligations for the liabilities, of entity C.

IE55. The board of entity C decides to enter into a financing arrangement with a syndicate of lenders to help fund the development of the gas field and construction of the LNG facility. The estimated total cost of the development and construction is CU1,000 million.[1]

IE56. The lending syndicate provides entity C with a CU700 million loan. The arrangement specifies that the syndicate has recourse to entities A and B only if entity C defaults on the loan arrangement during the development of the field and construction of the LNG facility. The lending syndicate agrees that it will not have recourse to entities A and B once the LNG facility is in production because it has assessed that the cash inflows that entity C should generate from LNG sales will be sufficient to meet the loan repayments. Although at this time the lenders have no recourse to entities A and B, the syndicate maintains protection against default by entity C by taking a lien on the LNG facility.

Analysis

IE57. The joint arrangement is carried out through a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The terms of the binding arrangement do not specify that the parties have rights to the assets, or obligations for the liabilities, of entity C, but they establish that the parties have rights to the net assets of entity C. The recourse nature of the financing arrangement during the development of the gas field and construction of the LNG facility (i.e., entities A and B providing separate guarantees during this phase) does not, by itself, impose on the parties an obligation for the liabilities of entity C (i.e., the loan is a liability of entity C). Entities A and B have separate liabilities, which are their guarantees to repay that loan if entity C defaults during the development and construction phase.

IE58. There are no other facts and circumstances that indicate that the parties have rights to substantially all the service potential or economic benefits of the assets of entity C and that the parties have an obligation for the liabilities of entity C. The joint arrangement is a joint venture.

IE59. The parties recognize their rights to the net assets of entity C as investments and account for them using the equity method.

Example 8—Accounting for acquisitions of interests in joint operations in which the activity constitutes an operation

IE60. Municipalities A, B and C have joint control of Joint Operation D whose activity constitutes an operation, as defined in IPSAS 40, *Public Sector Combinations*.

IE61. Municipality E acquires municipality A's 40 per cent ownership interest in Joint Operation D at a cost of CU300 and incurs acquisition-related costs of CU50.

IE62. The binding arrangement between the parties that Municipality E joined as part of the acquisition establishes that Municipality E's shares in several assets and liabilities differ from its ownership interest in Joint Operation D. The following table sets out Municipality E's share in the assets and liabilities related to Joint Operation D as established in the binding arrangement between the parties:

	Municipality E's share in the assets and liabilities related to Joint Operation D
Property, plant and equipment	48%
Intangible assets (excluding goodwill)	90%
Accounts receivable	40%
Inventory	40%
Retirement benefit obligations	15%
Accounts payable	40%
Contingent liabilities	56%

Analysis

IE63. Municipality E recognizes in its financial statements its share of the assets and liabilities resulting from the binding arrangement (see paragraph 23).

[1] In this example monetary amounts are denominated in 'currency units (CU)'.

IE64. It applies the principles on acquisition accounting in IPSAS 40 and other IPSASs for identifying, recognizing, measuring and classifying the assets acquired, and the liabilities assumed, on the acquisition of the interest in Joint Operation D. This is because Municipality E acquired an interest in a joint operation in which the activity constitutes an operation (see paragraph 24A).

IE65. However, Municipality E does not apply the principles on acquisition accounting in IPSAS 40 and other IPSASs that conflict with the guidance in this Standard. Consequently, in accordance with paragraph 23, Municipality E recognizes, and therefore measures, in relation to its interest in Joint Operation D, only its share in each of the assets that are jointly held and in each of the liabilities that are incurred jointly, as stated in the binding arrangement. Municipality E does not include in its assets and liabilities the shares of the other parties in Joint Operation D.

IE66. IPSAS 40 requires the acquirer to measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values with limited exceptions; for example, a reacquired right recognized as an intangible asset is measured on the basis of the remaining term of the related binding arrangement regardless of whether market participants would consider potential renewals of binding arrangements when measuring its fair value. Such measurement does not conflict with this Standard and thus those requirements apply.

IE67. Consequently, Municipality E determines the fair value, or other measure specified in IPSAS 40, of its share in the identifiable assets and liabilities related to Joint Operation D. The following table sets out the fair value or other measure specified by IPSAS 40 of Municipality E's shares in the identifiable assets and liabilities related to Joint Operation D:

	***Fair value or other measure specified by IPSAS 40 for Municipality E's shares in the identifiable assets and liabilities of Joint Operation D* (CU)**
Property, plant and equipment	138
Intangible assets (excluding goodwill)	72
Accounts receivable	84
Inventory	70
Retirement benefit obligations	(12)
Accounts payable	(48)
Contingent liabilities	(52)
Deferred tax liability (see the international or national standard dealing with income taxes)	(24)
Net assets	**228**

IE68. In accordance with IPSAS 40, the excess of the consideration transferred over the amount allocated to Municipality E's shares in the net identifiable assets is recognized as goodwill:

Consideration transferred	CU300
Municipality E's shares in the identifiable assets and liabilities relating to its interest in the joint operation	CU228
Goodwill	**CU72**

IE69. Acquisition-related costs of CU50 are not considered to be part of the consideration transferred for the interest in the joint operation. They are recognized as expenses in surplus or deficit in the period that the costs are incurred and the services are received (see paragraph 111 of IPSAS 40).

Example 9—Contributing the right to use know-how to a joint operation in which the activity constitutes an operation

IE70. Entities A and B are two entities whose activities are the construction of high performance batteries for diverse applications.

IE71. In order to develop batteries for electric vehicles they set up a binding arrangement (Joint Operation Z) to work together. Entities A and B share joint control of Joint Operation Z. This arrangement is a joint operation in which the activity constitutes an operation, as defined in IPSAS 40.

IE72. After several years, the joint operators (Entities A and B) concluded that it is feasible to develop a battery for electric vehicles using Material M. However, processing Material M requires specialist know-how and thus far, Material M has only been used in electricity generation.

IE73. In order to get access to existing know-how in processing Material M, Entities A and B arrange for Entity C to join as another joint operator by acquiring an interest in Joint Operation Z from Entities A and B and becoming a party to the binding arrangements.

IE74. Entity C's activity so far has been solely the generation of electricity. It has long-standing and extensive knowledge in processing Material M.

IE75. In exchange for its share in Joint Operation Z, Entity C pays cash to Entities A and B and grants the right to use its know-how in processing Material M for the purposes of Joint Operation Z. In addition, Entity C seconds some of its employees who are experienced in processing Material M to Joint Operation Z. However, Entity C does not transfer control of the know-how to Entities A and B or Joint Operation Z because it retains all the rights to it. In particular, Entity C is entitled to withdraw the right to use its know-how in processing Material M and to withdraw its seconded employees without any restrictions or compensation to Entity A and B or Joint Operation Z if it ceases its participation in Joint Operation Z.

IE76. The fair value of Entity C's know-how on the date of the acquisition of the interest in the joint operation is CU1,000. Immediately before the acquisition, the carrying amount of the know-how in the financial statements of Entity C was CU300.

Analysis

IE77. Entity C has acquired an interest in Joint Operation Z in which the activity of the joint operation constitutes an operation, as defined in IPSAS 40.

IE78. In accounting for the acquisition of its interest in the joint operation, Entity C applies all the principles on acquisition accounting in IPSAS 40 and other IPSASs that do not conflict with the guidance in this Standard (see paragraph 24A). Entity C therefore recognizes in its financial statements its share of the assets and liabilities resulting from the binding arrangement (see paragraph 23).

IE79. Entity C granted the right to use its know-how in processing Material M to Joint Operation Z as part of joining Joint Operation Z as a joint operator. However, Entity C retains control of this right because it is entitled to withdraw the right to use its know-how in processing Material M and to withdraw its seconded employees without any restrictions or any compensation to Entities A and B or Joint Operation Z if it ceases its participation in Joint Operation Z.

IE80. Consequently, Entity C continues to recognize the know-how in processing Material M after the acquisition of the interest in Joint Operation Z because it retains all the rights to it. This means that Entity C will continue to recognize the know-how based on its carrying amount of CU300. As a consequence of retaining control of the right to use the know-how that it granted to the joint operation, Entity C has granted the right to use the know-how to itself. Consequently, Entity C does not remeasure the know-how, and it does not recognize a gain or loss on the grant of the right to use it.

Comparison with IFRS 11

IPSAS 37, *Joint Arrangements,* is drawn primarily from IFRS 11, *Joint Arrangements* (issued in 2011, including amendments up to December 31, 2014). At the time of issuing this Standard, the IPSASB has not considered the applicability to public sector entities of IFRS 9, *Financial Instruments*. References to IFRS 9 in IFRS 11 are therefore replaced by references to the IPSASs dealing with financial instruments.

The main differences between IPSAS 37 and IFRS 11 are as follows:

- IPSAS 37 uses different terminology, in certain instances, from IFRS 11.The most significant examples are the use of the terms “controlling entity”, “surplus or deficit” and “accumulated surplus or deficit” in IPSAS 37. The equivalent terms in IFRS 11 are, “parent,” “profit or loss” and “retained earnings.”
- IPSAS 35 defines the term “binding arrangement”. This term is broader than the term “contractual arrangement”, which is used in IFRS 11.
- IPSAS 37 contains additional illustrative examples that reflect the public sector context.

IPSAS 38—DISCLOSURE OF INTERESTS IN OTHER ENTITIES

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Financial Reporting Standard (IFRS) 12, *Disclosures of Interests in Other Entities* published by the International Accounting Standards Board (IASB). Extracts from IFRS 12 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards Foundation.

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IPSAS 38—DISCLOSURE OF INTERESTS IN OTHER ENTITIES

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 38, *Disclosure of Interests in Other Entities* was issued in January 2015.

Since then, IPSAS 38 has been amended by the following IPSASs:

- *COVID-19: Deferral of Effective Dates* (issued November 2020)
- IPSAS 41, *Financial Instruments* (issued in August 14, 2018)
- IPSAS 39, *Employee Benefits* (issued July 2016)
- *The Applicability of IPSASs* (issued April 2016)

Table of Amended Paragraphs in IPSAS 38

Paragraph Affected	How Affected	Affected By
4	Amended	IPSAS 39 July 2016 IPSAS 41 August 2018
5	Deleted	The Applicability of IPSASs April 2016
6	Deleted	The Applicability of IPSASs April 2016
61A	New	The Applicability of IPSASs April 2016
61B	New	IPSAS 39 July 2016
61C	Amended	COVID-19: Deferral of Effective Dates November 2020

IPSAS 38—DISCLOSURE OF INTERESTS IN OTHER ENTITIES

CONTENTS

International Public Sector Accounting Standard 38, *Disclosure of Interests in Other Entities*, is set out in paragraphs 1–62. All the paragraphs have equal authority. IPSAS 38 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors,* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to require an entity to disclose information that enables users of its financial statements to evaluate:

    (a) The nature of, and risks associated with, its interests in controlled entities, unconsolidated controlled entities, joint arrangements and associates, and structured entities that are not consolidated; and

    (b) The effects of those interests on its financial position, financial performance and cash flows.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in disclosing information about its interests in controlled entities, unconsolidated controlled entities, joint arrangements and associates, and structured entities that are not consolidated.**

3. **This Standard shall be applied by an entity that has an interest in any of the following:**

    (a) **Controlled entities;**

    (b) **Joint arrangements (i.e., joint operations or joint ventures);**

    (c) **Associates; or**

    (d) **Structured entities that are not consolidated.**

4. **This Standard does not apply to:**

    (a) **Post-employment benefit plans or other long-term employee benefit plans to which IPSAS 39, *Employee Benefits* applies.**

    (b) **An entity's separate financial statements to which IPSAS 34, *Separate Financial Statements,* applies. However:**

        (i) **If an entity has interests in structured entities that are not consolidated and prepares separate financial statements as its only financial statements, it shall apply the requirements in paragraphs 40–48 when preparing those separate financial statements.**

        (ii) **An investment entity that prepares financial statements in which all of its controlled entities are measured at fair value through surplus or deficit in accordance with paragraph 56 of IPSAS 35 shall present the disclosures relating to investment entities required by this Standard.**

    (c) **An interest held by an entity that participates in, but does not have joint control of, a joint arrangement unless that interest results in significant influence over the arrangement or is an interest in a structured entity.**

    (d) **An interest in another entity that is accounted for in accordance with IPSAS 41, *Financial Instruments*. However, an entity shall apply this Standard:**

        (i) **When that interest is an interest in an associate or a joint venture that, in accordance with IPSAS 36, *Investments in Associates* and *Joint Ventures*, is measured at fair value through surplus or deficit; or**

        (ii) **When that interest is an interest in a structured entity that is not consolidated.**

5. [Deleted]

6. [Deleted]

Definitions

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

    <u>Binding arrangement</u>: For the purposes of this Standard, a binding arrangement is an arrangement that confers enforceable rights and obligations on the parties to it as if it were in the form of a contract. It includes rights from contracts or other legal rights.

    An <u>interest in another entity</u>, for the purpose of this Standard, refers to involvement by way of binding arrangements or otherwise that exposes an entity to variability of benefits from the performance of the other entity. An interest in another entity can be evidenced by, but is not limited to, the holding of equity or debt instruments as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement and guarantees. It

includes the means by which an entity has control or joint control of, or significant influence over, another entity. An entity does not necessarily have an interest in another entity solely because of a typical funder/recipient or customer/supplier relationship.

Paragraphs AG7–AG9 provide further information about interests in other entities.

Paragraphs AG57–AG59 of IPSAS 35, *Consolidated Financial Statements* explain variability of benefits.

<u>Revenue from a structured entity</u>, for the purpose of this Standard, includes, but is not limited to, recurring and non-recurring fees, interest, dividends or similar distributions, gains or losses on the remeasurement or derecognition of interests in structured entities and gains or losses from the transfer of assets and liabilities to the structured entity.

A <u>structured entity</u> is:

(a) **In the case of entities where administrative arrangements or legislation are normally the dominant factors in deciding who has control of an entity, an entity that has been designed so that administrative arrangements or legislation are not the dominant factors in deciding who controls the entity, such as when binding arrangements are significant to determining control of the entity and relevant activities are directed by means of binding arrangements; or**

(b) **In the case of entities where voting or similar rights are normally the dominant factor in deciding who has control of an entity, an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of binding arrangements.**

Paragraphs AG20–AG23 provide further information about structured entities.

Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately. The following terms are defined in either IPSAS 34, *Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements*, IPSAS 36, *Investments in Associates and Joint Ventures* or IPSAS 37, *Joint Arrangements*: associate, consolidated financial statements, control, controlled entity, controlling entity, economic entity, equity method, investment entity, joint arrangement, joint control, joint operation, joint venture, non-controlling interest, relevant activities, separate financial statements, separate vehicle and significant influence.

Binding Arrangement

8. Binding arrangements can be evidenced in several ways. A binding arrangement is often, but not always, in writing, in the form of a contract or documented discussions between the parties. Statutory mechanisms such as legislative or executive authority can also create enforceable arrangements, similar to contractual arrangements, either on their own or in conjunction with contracts between the parties.

Disclosing Information about Interests in Other Entities

9. **To meet the objective in paragraph 1, an entity shall disclose:**

(a) **The significant judgments and assumptions it has made in determining:**

(i) **The nature of its interest in another entity or arrangement;**

(ii) **The type of joint arrangement in which it has an interest (paragraphs 12–14); and**

(iii) **That it meets the definition of an investment entity, if applicable (paragraph 15); and**

(b) **Information about its interests in:**

(i) **Controlled entities (paragraphs 17–26);**

(ii) **Joint arrangements and associates (paragraphs 35–39);**

(iii) **Structured entities that are not consolidated (paragraphs 40–48);**

(iv) **Non-quantifiable ownership interests (paragraphs 49–50); and**

(v) **Controlling interests acquired with the intention of disposal (paragraphs 51–57).**

10. **If the disclosures required by this Standard, together with disclosures required by other IPSASs, do not meet the objective in paragraph 1, an entity shall disclose whatever additional information is necessary to meet that objective.**

11. **An entity shall consider the level of detail necessary to satisfy the disclosure objective in paragraph 1 and how much emphasis to place on each of the requirements in this Standard. It shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics (see paragraphs AG2–AG6).**

Significant Judgments and Assumptions

12. **An entity shall disclose the methodology used to determine:**
    (a) **That it has control of another entity as described in paragraphs 18 and 20 of IPSAS 35;**
    (b) **That it has joint control of an arrangement or significant influence over another entity; and**
    (c) **The type of joint arrangement (i.e., joint operation or joint venture) when the arrangement has been structured through a separate vehicle.**

13. **The disclosures required by paragraph 12 shall be either given in the financial statements or incorporated by cross-reference from the financial statements to some other statement that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete. The use of such cross-referencing may be subject to jurisdictional restrictions.**

14. **To comply with paragraph 12, an entity shall disclose, for example, the factors considered in determining that:**
    (a) **It controls a specific entity (or similar category of entities) where the interest in the other entity is not evidenced by the holding of equity or debt instruments;**
    (b) **It does not control another entity (or category of entities) even though it holds more than half of the voting rights of the other entity (or entities);**
    (c) **It controls another entity (or category of entities) even though it holds less than half of the voting rights of the other entity (or entities);**
    (d) **It is an agent or a principal (see paragraphs AG60–AG74 of IPSAS 35);**
    (e) **It does not have significant influence even though it holds 20 per cent or more of the voting rights of another entity; and**
    (f) **It has significant influence even though it holds less than 20 per cent of the voting rights of another entity.**

Investment Entity Status

15. **When a controlling entity determines that it is an investment entity in accordance with IPSAS 35, the investment entity shall disclose information about significant judgments and assumptions it has made in determining that it is an investment entity. An investment entity is not required to disclose this information if it has all of the characteristics in paragraph 61 of IPSAS 35.**

16. **When an entity becomes, or ceases to be, an investment entity, it shall disclose the change of investment entity status and the reasons for the change. In addition, an entity that becomes an investment entity shall disclose the effect of the change of status on the financial statements for the period presented, including:**
    (a) **The total fair value, as of the date of change of status, of the controlled entities that cease to be consolidated;**
    (b) **The total gain or loss, if any, calculated in accordance with paragraph 64 of IPSAS 35; and**
    (c) **The line item(s) in surplus or deficit in which the gain or loss is recognized (if not presented separately).**

Interests in Controlled Entities

17. **An entity shall disclose information that enables users of its consolidated financial statements:**
    (a) **To understand:**
        (i) **The composition of the economic entity; and**
        (ii) **The interest that non-controlling interests have in the economic entity's activities and cash flows (paragraph 19); and**

(b) **To evaluate:**

(i) **The nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the economic entity (paragraph 20);**

(ii) **The nature of, and changes in, the risks associated with its interests in consolidated structured entities (paragraphs 21–24);**

(iii) **The consequences of changes in its ownership interest in a controlled entity that do not result in a loss of control (paragraph 25); and**

(iv) **The consequences of losing control of a controlled entity during the reporting period (paragraph 26).**

18. **When the financial statements of a controlled entity used in the preparation of consolidated financial statements are as of a date or for a period that is different from that of the consolidated financial statements (see paragraph 46 of IPSAS 35) an entity shall disclose:**

(a) **The date of the end of the reporting period of the financial statements of that controlled entity; and**

(b) **The reason for using a different date or period.**

The Interest that Non-controlling Interests have in the Economic Entity's Activities and Cash Flows

19. **An entity shall disclose for each of its controlled entities that have non-controlling interests that are material to the reporting entity:**

(a) **The name of the controlled entity;**

(b) **The domicile and legal form of the controlled entity and the jurisdiction in which it operates;**

(c) **The proportion of ownership interests held by non-controlling interests;**

(d) **The proportion of voting rights held by non-controlling interests, if different from the proportion of ownership interests held;**

(e) **The surplus or deficit allocated to non-controlling interests of the controlled entity during the reporting period;**

(f) **Accumulated non-controlling interests of the controlled entity at the end of the reporting period; and**

(g) **Summarized financial information about the controlled entity (see paragraph AG10).**

The Nature and Extent of Significant Restrictions

20. **An entity shall disclose:**

(a) **Significant restrictions in binding arrangements (e.g., statutory, contractual and regulatory restrictions) on its ability to access or use the assets and settle the liabilities of the economic entity, such as:**

(i) **Those that restrict the ability of a controlling entity or its controlled entities to transfer cash or other assets to (or from) other entities within the economic entity.**

(ii) **Guarantees or other requirements that may restrict dividends and other capital distributions being paid, or loans and advances being made or repaid, to (or from) other entities within the economic entity.**

(b) **The nature and extent to which protective rights of non-controlling interests can significantly restrict the entity's ability to access or use the assets and settle the liabilities of the** economic entity **(such as when a controlling entity is obliged to settle liabilities of a controlled entity before settling its own liabilities, or approval of non-controlling interests is required either to access the assets or to settle the liabilities of a controlled entity).**

(c) **The carrying amounts in the consolidated financial statements of the assets and liabilities to which those restrictions apply.**

Nature of the Risks Associated with an Entity's Interests in Consolidated Structured Entities

21. **An entity shall disclose the terms of any binding arrangements that could require the controlling entity or its controlled entities to provide financial support to a consolidated structured entity, including events or circumstances**

that could expose the reporting entity to a loss (e.g., liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or provide financial support).

22. **If during the reporting period a controlling entity or any of its controlled entities has, without having an obligation under a binding arrangement to do so, provided financial or other support to a consolidated structured entity (e.g., purchasing assets of, or instruments issued by, the structured entity), the entity shall disclose:**

    (a) **The type and amount of support provided, including situations in which the controlling entity or its controlled entities assisted the structured entity in obtaining financial support; and**

    (b) **The reasons for providing the support.**

23. **If during the reporting period a controlling entity or any of its controlled entities has, without having an obligation under a binding arrangement to do so, provided financial or other support to a previously unconsolidated structured entity and that provision of support resulted in the entity controlling the structured entity, the entity shall disclose an explanation of the relevant factors in reaching that decision.**

24. **An entity shall disclose any current intentions to provide financial or other support to a consolidated structured entity, including intentions to assist the structured entity in obtaining financial support.**

Consequences of Changes in a Controlling Entity's Ownership Interest in a Controlled Entity that do not Result in a Loss of Control

25. **An entity shall present a schedule that shows the effects on the net assets/equity attributable to owners of the controlling entity of any changes in its ownership interest in a controlled entity that do not result in a loss of control.**

Consequences of Losing Control of a Controlled Entity During the Reporting Period

26. **An entity shall disclose the gain or loss, if any, calculated in accordance with paragraph 52 of IPSAS 35 and:**

    (a) **The portion of that gain or loss attributable to measuring any investment retained in the former controlled entity at its fair value at the date when control is lost; and**

    (b) **The line item(s) in surplus or deficit in which the gain or loss is recognized (if not presented separately).**

Interests in Unconsolidated Controlled Entities (Investment Entities)

27. **An investment entity that, in accordance with IPSAS 35 is required to apply the exception to consolidation and instead account for its investment in a controlled entity at fair value through surplus or deficit shall disclose that fact.**

28. **For each unconsolidated controlled entity, an investment entity shall disclose:**

    (a) **The controlled entity's name;**

    (b) **The domicile and legal form of the controlled entity and the jurisdiction in which it operates; and**

    (c) **The proportion of ownership interest held by the investment entity and, if different, the proportion of voting rights held.**

29. **If an investment entity is the controlling entity of another investment entity, the controlling entity shall also provide the disclosures in paragraph 28(a)–(c) for investments that are controlled by its controlled investment entity. The disclosure may be provided by including, in the financial statements of the controlling entity, the financial statements of the controlled entity (or controlled entities) that contain the above information.**

30. **An investment entity shall disclose:**

    (a) **The nature and extent of any significant restrictions arising from binding arrangements (e.g., resulting from borrowing arrangements, regulatory requirements or contractual arrangements) on the ability of an unconsolidated controlled entity to transfer funds to the investment entity in the form of cash dividends, or similar distributions, or to repay loans or advances made to the unconsolidated controlled entity by the investment entity; and**

    (b) **Any current commitments or intentions to provide financial or other support to an unconsolidated controlled entity, including commitments or intentions to assist the controlled entity in obtaining financial support.**

31. **If, during the reporting period, an investment entity or any of its controlled entities has, without having an obligation arising from a binding arrangement to do so, provided financial or other support to an unconsolidated controlled**

entity (e.g., purchasing assets of, or instruments issued by, the controlled entity or assisting the controlled entity in obtaining financial support), the entity shall disclose:

(a) **The type and amount of support provided to each unconsolidated controlled entity; and**

(b) **The reasons for providing the support.**

32. **An investment entity shall disclose the terms of any binding arrangements that could require the entity or its unconsolidated controlled entities to provide financial support to an unconsolidated, controlled, structured entity, including events or circumstances that could expose the reporting entity to a loss (e.g., liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or to provide financial support).**

33. **If during the reporting period an investment entity or any of its unconsolidated controlled entities has, without having an obligation arising from a binding arrangement to do so, provided financial or other support to an unconsolidated, structured entity that the investment entity did not control, and if that provision of support resulted in the investment entity controlling the structured entity, the investment entity shall disclose an explanation of the relevant factors in reaching the decision to provide that support.**

34. **A controlling entity that controls an investment entity and is not itself an investment entity, shall disclose in its consolidated financial statements, the information required by paragraphs 27 to 33 in respect of such unconsolidated controlled entities.**

Interests in Joint Arrangements and Associates

35. **An entity shall disclose information that enables users of its financial statements to evaluate:**

(a) **The nature, extent and financial effects of its interests in joint arrangements and associates, including the nature and effects of its relationship with the other investors with joint control of, or significant influence over, joint arrangements and associates (paragraphs 36 and 38); and**

(b) **The nature of, and changes in, the risks associated with its interests in joint ventures and associates** (paragraph 39).

Nature, Extent and Financial Effects of an Entity's Interests in Joint Arrangements and Associates

36. **An entity shall disclose:**

(a) **For each joint arrangement and associate that is material to the reporting entity:**

(i) **The name of the joint arrangement or associate;**

(ii) **The nature of the entity's relationship with the joint arrangement or associate (by, for example, describing the nature of the activities of the joint arrangement or associate and whether they are strategic to the entity's activities);**

(iii) **The domicile and legal form of the joint arrangement or associate and the jurisdiction in which it operates; and**

(iv) **The proportion of ownership interest or participating share held by the entity and, if different, the proportion of voting rights held (if applicable).**

(b) **For each joint venture and associate that is material to the reporting entity:**

(i) **Whether the investment in the joint venture or associate is measured using the equity method or at fair value;**

(ii) **Summarized financial information about the joint venture or associate as specified in paragraphs AG12 and AG13; and**

(iii) **If the joint venture or associate is accounted for using the equity method, the fair value of its investment in the joint venture or associate, if there is a quoted market price for the investment.**

(c) **Financial information as specified in paragraph AG16 about the entity's investments in joint ventures and associates that are not individually material:**

(i) **In aggregate for all individually immaterial joint ventures; and**

(ii) **In aggregate for all individually immaterial associates. This aggregated information is to be disclosed separately from the aggregated information on joint ventures.**

37. An investment entity need not provide the disclosures required by paragraphs 36(b)–36(c).

38. **An entity shall also disclose:**

(a) **The nature and extent of any significant restrictions (e.g., resulting from borrowing arrangements, regulatory requirements or binding arrangements between investors with joint control of, or significant influence over, a joint venture or an associate) on the ability of joint ventures or associates to transfer funds to the entity in the form of cash dividends or similar distributions, or to repay loans or advances made by the entity.**

(b) **When the financial statements of a joint venture or associate used in applying the equity method are as of a date or for a period that is different from that of the entity:**

(i) **The date of the end of the reporting period of the financial statements of that joint venture or associate; and**

(ii) **The reason for using a different date or period.**

(c) **The unrecognized share of losses of a joint venture or associate, both for the reporting period and cumulatively, if the entity has stopped recognizing its share of losses of the joint venture or associate when applying the equity method.**

Risks Associated with an Entity's Interests in Joint Ventures and Associates

39. **An entity shall disclose:**

(a) **Commitments that it has relating to its joint ventures separately from the amount of other commitments as specified in paragraphs AG17–AG19; and**

(b) **In accordance with IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, unless the probability of loss is remote, contingent liabilities incurred relating to its interests in joint ventures or associates (including its share of contingent liabilities incurred jointly with other investors with joint control of, or significant influence over, the joint ventures or associates), separately from the amount of other contingent liabilities.**

Interests in Structured Entities that are not Consolidated

40. **An entity shall disclose information that enables users of its financial statements**:

(a) **To understand the nature and extent of its interests in structured entities that are not consolidated (paragraphs 43–45); and**

(b) **To evaluate the nature of, and changes in, the risks associated with its interests in structured entities that are not consolidated (paragraphs 46–48).**

41. The information required by paragraph 40(b) includes information about an entity's exposure to risk from involvement that it had with structured entities that are not consolidated in previous periods (e.g., sponsoring the structured entity), even if the entity no longer has any involvement by way of binding arrangement with the structured entity at the reporting date.

42. An investment entity need not provide the disclosures required by paragraph 40 for a structured entity that it controls but which is not consolidated, and for which it presents the disclosures required by paragraphs 27–33.

Nature of Interests

43. **An entity shall disclose qualitative and quantitative information about its interests in structured entities that are not consolidated, including, but not limited to, the nature, purpose, size and activities of the structured entity and how the structured entity is financed.**

44. **If an entity has sponsored a structured entity that is not consolidated for which it does not provide information required by paragraph 46 (e.g., because it does not have an interest in the entity at the reporting date), the entity shall disclose:**

(a) **How it has determined which structured entities it has sponsored;**

(b) **Revenue from those structured entities during the reporting period, including a description of the types of revenue presented; and**

(c) **The carrying amount (at the time of transfer) of all assets transferred to those structured entities during the reporting period.**

45. **An entity shall present the information in paragraph 44(b) and (c) in tabular format, unless another format is more appropriate, and classify its sponsoring activities into relevant categories (see paragraphs AG2–AG6).**

Nature of Risks

46. **An entity shall disclose in tabular format, unless another format is more appropriate, a summary of:**

   (a) **The carrying amounts of the assets and liabilities recognized in its financial statements relating to its interests in structured entities that are not consolidated;**

   (b) **The line items in the statement of financial position in which those assets and liabilities are recognized;**

   (c) **The amount that best represents the entity's maximum exposure to loss from its interests in structured entities that are not consolidated, including how the maximum exposure to loss is determined. If an entity cannot quantify its maximum exposure to loss from its interests in structured entities that are not consolidated it shall disclose that fact and the reasons; and**

   (d) **A comparison of the carrying amounts of the assets and liabilities of the entity that relate to its interests in structured entities that are not consolidated and the entity's maximum exposure to loss from those entities.**

47. **If during the reporting period an entity has, without having an obligation under a binding arrangement to do so, provided financial or other support to a structured entity that is not consolidated in which it previously had or currently has an interest (for example, purchasing assets of, or instruments issued by, the structured entity), the entity shall disclose:**

   (a) **The type and amount of support provided, including situations in which the entity assisted the structured entity in obtaining financial support; and**

   (b) **The reasons for providing the support.**

48. **An entity shall disclose any current intentions to provide financial or other support to a structured entity that is not consolidated, including intentions to assist the structured entity in obtaining financial support. Such current intentions include intentions to provide support as a result of obligations under binding arrangements and intentions to provide support where the entity has no obligation under a binding arrangement.**

Non-quantifiable Ownership Interests

49. **An entity shall disclose information that enables users of its financial statements to understand the nature and extent of any non-quantifiable ownership interests in other entities.**

50. **To the extent that this information has not already been provided in accordance with this Standard, an entity shall disclose, in respect of each non-quantifiable ownership interest that is material to the reporting entity:**

   (a) **The name of the entity in which it has an ownership interest; and**

   (b) **The nature of its ownership interest in the entity.**

Controlling Interests Acquired with the Intention of Disposal

51. **An entity, other than an investment entity, shall disclose information regarding its interest in a controlled entity when, at the point at which control arose, the entity had the intention of disposing of that interest and, at the reporting date, it has an active intention to dispose of that interest.**

52. There are a number of situations in which a public sector entity may obtain control of another entity, but where the entity has an active intention to dispose of all or part of its controlling interest in the near future.

53. Because of a government's broad responsibility for the economic well-being of a jurisdiction it may intervene to prevent the consequences of failure of an entity, such as a financial institution. Such interventions may lead to a government obtaining control of another entity, although it has no intention of maintaining control over that entity. Rather, its intention may be to sell, or otherwise dispose of, its interest in the controlled entity. If the other entity needs to be restructured to facilitate disposal the restructuring can occur over a period of one or more years and the government may retain some residual assets or liabilities at the end of the process. The consolidation of such controlled entities for the reporting periods in which control is present, can have a significant impact on the consolidated financial statements. The obtaining of control as a result of interventions to prevent failure is most likely to occur in the context of governments, but could also occur in the case of individual public sector entities.

54. A public sector entity may also acquire a controlling interest in another entity, with the intention of disposing of all or part of that interest, in implementing a government's policy objectives. For example, a government may direct an entity to acquire certain interests in other entities for the purpose of redistribution.

55. **An entity shall disclose the following information in the notes in respect of each controlled entity referred to in paragraph 51:**

    (a) **The name of the controlled entity and a description of its key activities;**

    (b) **The rationale for the acquisition of the controlling interest and the factors considered in determining that control exists;**

    (c) **The impact on the consolidated financial statements of consolidating the controlled entity including the effect on assets, liabilities, revenue, expenses and net assets/equity; and**

    (d) **The current status of the approach to disposal, including the expected method and timing of disposal.**

56. **The disclosures required by paragraph 55 shall be provided at each reporting date until the entity disposes of the controlling interest or ceases to have the intention to dispose of that interest. In the period in which the entity disposes of the controlling interest or ceases to have the intention to dispose of the controlling interest it shall disclose:**

    (a) **The fact that there has been a disposal or change of intention; and**

    (b) **The effect of the disposal or change of intention on the consolidated financial statements.**

57. **Where other disclosures required by this Standard or other IPSASs would provide information relevant to paragraphs 55 or 56 a cross-reference to those other disclosures shall be provided.**

Transitional Provisions

58. An entity is encouraged to provide information required by this Standard earlier than annual periods beginning on or after January 1, 2017. Providing some of the disclosures required by this Standard does not compel the entity to comply with all the requirements of this Standard or to apply IPSAS 34, IPSAS 35, IPSAS 36, and IPSAS 37 early.

59. The disclosure requirements of this Standard need not be applied for any period presented that begins before the annual period immediately preceding the first annual period for which this Standard is applied.

60. The disclosure requirements of paragraphs 40–56 and the corresponding guidance in paragraphs AG20–AG25 of this Standard need not be applied for any period presented that begins before the first annual period for which this Standard is applied.

Effective Date

61. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged.**

61A. **Paragraphs 5 and 6 were deleted by *The Applicability of IPSASs*, issued in April 2016. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2018, it shall disclose that fact.**

61B. **Paragraph 4 was amended by IPSAS 39, *Employee Benefits*, issued in July 2016. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2018 it shall disclose that fact and apply IPSAS 39 at the same time.**

61C. **Paragraph 4 was amended by IPSAS 41, in August 2018. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2023 it shall disclose that fact and apply IPSAS 41 at the same time.**

62. When an entity adopts the accrual basis IPSASs as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs),* for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 38.

AG1. The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying this Standard.

Aggregation (paragraph 11)

AG2. An entity shall decide, in the light of its circumstances, how much detail it provides to satisfy the information needs of users, how much emphasis it places on different aspects of the requirements and how it aggregates the information. It is necessary to strike a balance between burdening financial statements with excessive detail that may not assist users of financial statements and obscuring information as a result of too much aggregation.

AG3. An entity may aggregate the disclosures required by this Standard for interests in similar entities if aggregation is consistent with the disclosure objective and the requirement in paragraph AG4, and does not obscure the information provided. An entity shall disclose how it has aggregated its interests in similar entities.

AG4. An entity shall present information separately for interests in:

(a) Controlled entities;

(b) Joint ventures;

(c) Joint operations;

(d) Associates; and

(e) Structured entities that are not consolidated.

AG5. In determining whether to aggregate information, an entity shall consider quantitative and qualitative information about the different risk and benefit characteristics of each entity it is considering for aggregation and the significance of each such entity to the reporting entity. The entity shall present the disclosures in a manner that clearly explains to users of financial statements the nature and extent of its interests in those other entities.

AG6. Examples of aggregation levels within the classes of entities set out in paragraph AG4 that might be appropriate are:

(a) Nature of activities (e.g., a research and development entity, a revolving credit card securitization entity).

(b) Industry classification.

(c) Geography (e.g., country or region).

Interests in Other Entities

AG7. An interest in another entity refers to involvement by way of binding arrangements or otherwise that exposes the reporting entity to variability of benefits from the performance of the other entity. Consideration of the purpose and design of the other entity may help the reporting entity when assessing whether it has an interest in that entity and, therefore, whether it is required to provide the disclosures in this Standard. That assessment shall include consideration of the risks that the other entity was designed to create and the risks the other entity was designed to pass on to the reporting entity and other parties.

AG8. A reporting entity is typically exposed to variability of benefits from the performance of another entity by holding instruments (such as equity or debt instruments issued by the other entity) or having another involvement that absorbs variability. For example, assume a structured entity holds a loan portfolio. The structured entity obtains a credit default swap from another entity (the reporting entity) to protect itself from the default of interest and principal payments on the loans. The reporting entity has involvement that exposes it to variability of benefits from the performance of the structured entity because the credit default swap absorbs variability of benefits, in the form of returns, of the structured entity.

AG9. Some instruments are designed to transfer risk from a reporting entity to another entity. Such instruments create variability of benefits for the other entity but do not typically expose the reporting entity to variability of benefits from the performance of the other entity. For example, assume a structured entity is established to provide investment opportunities for investors who wish to have exposure to entity Z's credit risk (entity Z is unrelated to any party involved in the arrangement). The structured entity obtains funding by issuing to those investors notes that are linked to entity Z's credit risk (credit-linked notes) and uses the proceeds to invest in a portfolio of risk-free financial assets. The structured entity obtains exposure to entity Z's credit risk by entering into a credit default swap (CDS) with a swap counterparty. The CDS passes entity Z's credit risk to the structured entity in return for a fee paid by the swap counterparty. The investors in the structured entity receive higher benefits that reflect both the structured entity's return from its asset portfolio and the CDS fee. The swap counterparty does not have involvement with the structured entity that exposes it to variability of benefits from the performance of the structured entity because the CDS transfers variability to the structured entity, rather than absorbing variability of benefits of the structured entity.

Summarized Financial Information for Controlled Entities, Joint Ventures and Associates (paragraphs 19 and 36)

AG10. For each controlled entity that has non-controlling interests that are material to the reporting entity, an entity shall disclose:

(a) Dividends or similar distributions paid to non-controlling interests; and

(b) Summarized financial information about the assets, liabilities, surplus or deficit and cash flows of the controlled entity that enables users to understand the interest that non-controlling interests have in the economic entity's activities and cash flows. That information might include but is not limited to, for example, current assets, non-current assets, current liabilities, non-current liabilities, revenue and surplus or deficit.

AG11. The summarized financial information required by paragraph AG10(b) shall be the amounts before inter-entity eliminations.

AG12. For each joint venture and associate that is material to the reporting entity, an entity shall disclose:

(a) Dividends or similar distributions received from the joint venture or associate; and

(b) Summarized financial information for the joint venture or associate (see paragraphs AG14 and AG15) including, but not necessarily limited to:

(i) Current assets;

(ii) Non-current assets;

(iii) Current liabilities;

(iv) Non-current liabilities;

(v) Revenue;

(vi) Tax expense;

(vii) Pre-tax gain or loss recognized on the disposal of assets or settlement of liabilities attributable to discontinuing operations; and

(viii) Surplus or deficit.

AG13. In addition to the summarized financial information required by paragraph AG12, an entity shall disclose for each joint venture that is material to the reporting entity the amount of:

(a) Cash and cash equivalents included in paragraph AG12(b)(i);

(b) Current financial liabilities (excluding taxes and transfers payable, payables under exchange transactions and provisions) included in paragraph AG12(b)(iii);

(c) Non-current financial liabilities (excluding taxes and transfers payable, payables under exchange transactions and provisions) included in paragraph AG12(b)(iv);

(d) Depreciation and amortization;

(e) Interest revenue;

(f) Interest expense; and

(g) Income tax expense.

AG14. The summarized financial information presented in accordance with paragraphs AG12 and AG13 shall be the amounts included in the IPSAS financial statements of the joint venture or associate (and not the entity's share of those amounts). If the entity accounts for its interest in the joint venture or associate using the equity method:

(a) The amounts included in the IPSAS financial statements of the joint venture or associate shall be adjusted to reflect adjustments made by the entity when using the equity method, such as fair value adjustments made at the time of acquisition and adjustments for differences in accounting policies.

(b) The entity shall provide a reconciliation of the summarized financial information presented to the carrying amount of its interest in the joint venture or associate.

AG15. An entity may present the summarized financial information required by paragraphs AG12 and AG13 on the basis of the joint venture's or associate's financial statements if:

(a) The entity measures its interest in the joint venture or associate at fair value in accordance with IPSAS 36; and

(b) The joint venture or associate does not prepare IPSAS financial statements and preparation on that basis would be impracticable or cause undue cost.

In that case, the entity shall disclose the basis on which the summarized financial information has been prepared.

AG16. An entity shall disclose, in aggregate, the carrying amount of its interests in all individually immaterial joint ventures or associates that are accounted for using the equity method. An entity shall also disclose separately the aggregate amount of its share of those joint ventures' or associates':

(a) Revenue.

(b) Tax expense.

(c) Pre-tax gain or loss recognized on the disposal of assets or settlement of liabilities attributable to discontinuing operations.

(d) Surplus or deficit.

(e) An entity provides the disclosures separately for joint ventures and associates.

Commitments for Joint Ventures (paragraph 39(a))

AG17. An entity shall disclose total commitments it has made but not recognized at the reporting date (including its share of commitments made jointly with other investors with joint control of a joint venture) relating to its interests in joint ventures. Commitments are those that may give rise to a future outflow of cash or other resources.

AG18. Unrecognized commitments that may give rise to a future outflow of cash or other resources include:

(a) Unrecognized commitments to contribute funding or resources as a result of, for example:

(i) The constitution or acquisition agreements of a joint venture (that, for example, require an entity to contribute funds over a specific period).

(ii) Capital-intensive projects undertaken by a joint venture.

(iii) Unconditional purchase obligations, comprising procurement of equipment, inventory or services that an entity is committed to purchasing from, or on behalf of, a joint venture.

(iv) Unrecognized commitments to provide loans or other financial support to a joint venture.

(v) Unrecognized commitments to contribute resources to a joint venture, such as assets or services.

(vi) Other non-cancellable unrecognized commitments relating to a joint venture.

(b) Unrecognized commitments to acquire another party's ownership interest (or a portion of that ownership interest) in a joint venture if a particular event occurs or does not occur in the future.

AG19. The requirements and examples in paragraphs AG17 and AG18 illustrate some of the types of disclosure required by paragraph 27 of IPSAS 20, *Related Party Disclosures*.

Interests in Structured Entities that are not Consolidated (paragraphs 40–48)

Structured Entities

AG20. A structured entity is an entity that has been designed so that the conventional ways in which an entity is controlled are not the dominant factors in deciding who controls the entity. In the case of entities such as departments or ministries where administrative arrangements or legislation are often the dominant factors in deciding who has control of an entity, a structured entity is an entity that has been designed so that administrative arrangements or legislation are not the dominant factor in deciding who controls the entity. In the case of entities where voting or similar rights are normally the dominant factor in deciding who has control of an entity (which may be the case for some entities with profit objectives), a structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity. Although binding arrangements frequently occur between public sector entities, binding arrangements are not normally the dominant factor in determining who controls an entity. Therefore the use of binding arrangements to determine the relevant activities of an entity may indicate the existence of a structured entity. Depending on the context a structured entity could be (i) an entity for which most of the activities are predetermined, with the relevant activities limited in scope but directed through binding arrangements or (ii) an entity for which any voting rights relate to administrative tasks only and the relevant activities are directed by means of binding arrangements.

AG21. A structured entity often has some or all of the following features or attributes:

(a) Restricted activities.

(b) A narrow and well-defined objective, such as to carry out research and development activities, provide a source of capital or funding to an entity or provide investment opportunities for investors by passing on risks and rewards associated with the assets of the structured entity to investors.

(c) Insufficient net assets/equity to permit the structured entity to finance its activities without subordinated financial support.

(d) Financing in the form of multiple contractually linked instruments to investors that create concentrations of credit or other risks (tranches).

AG22. Examples of entities that are regarded as structured entities include, but are not limited to:

(a) A partnership between a government and a private sector entity that is not a joint venture, being a partnership established and directed by binding arrangements.

(b) Securitization vehicles.

(c) Asset-backed financings.

(d) Some investment funds.

AG23. The mere fact that a government provides funding to another entity does not make that entity a structured entity. Nor is an entity that is controlled by voting rights a structured entity simply because, for example, it receives funding from third parties following a restructuring.

Nature of Risks from Interests in Structured Entities that are not Consolidated (paragraphs 46–48)

AG24. In addition to the information required by paragraphs 46–48, an entity shall disclose additional information that is necessary to meet the disclosure objective in paragraph 40(b).

AG25. Examples of additional information that, depending on the circumstances, might be relevant to an assessment of the risks to which an entity is exposed when it has an interest in a structured entity that is not consolidated are:

(a) The terms of an arrangement that could require the entity to provide financial support to a structured entity that is not consolidated (e.g., liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or provide financial support), including:

(i) A description of events or circumstances that could expose the reporting entity to a loss.

(ii) Whether there are any terms that would limit the obligation.

(iii) Whether there are any other parties that provide financial support and, if so, how the reporting entity's obligation ranks with those of other parties.

(b) Losses incurred by the entity during the reporting period relating to its interests in structured entities that are not consolidated.

(c) The types of revenue the entity received during the reporting period from its interests in structured entities that are not consolidated.

(d) Whether the entity is required to absorb losses of a structured entity that is not consolidated before other parties, the maximum limit of such losses for the entity, and (if relevant) the ranking and amounts of potential losses borne by parties whose interests rank lower than the entity's interest in the structured entity that is not consolidated.

(e) Information about any liquidity arrangements, guarantees or other commitments with third parties that may affect the fair value or risk of the entity's interests in structured entities that are not consolidated.

(f) Any difficulties a structured entity that is not consolidated has experienced in financing its activities during the reporting period.

(g) In relation to the funding of a structured entity that is not consolidated, the forms of funding (e.g., commercial paper or medium-term notes) and their weighted-average life. That information might include maturity analyses of the assets and funding of a structured entity if the structured entity has longer-term assets funded by shorter-term funding.

Appendix B

Amendments to Other IPSASs

[Deleted]

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 38, Disclosure of Interests in Other Entities.

Objective

BC1. This Basis for Conclusions summarizes the IPSASB‘s considerations in reaching the conclusions in IPSAS 38. As this Standard is based on IFRS 12, *Disclosure of Interests in Other Entities* (issued in 2011, including amendments up to December 31, 2014), issued by the IASB, the Basis for Conclusions outlines only those areas where IPSAS 38 departs from the main requirements of IFRS 12.

Overview

BC2. In 2012 the IPSASB commenced work on a project to update those IPSASs that dealt with accounting for interests in controlled entities, associates and joint ventures. In October 2013 the IPSASB issued Exposure Drafts (EDs) 48 to 52 which were collectively referred to as *Interests in Other Entities*. ED 52, *Disclosure of Interests in Other Entities*, was based on IFRS 12, *Disclosure of Interests in Other Entities*, having regard to the relevant public sector modifications to the disclosure requirements in IPSAS 6, *Consolidated and Separate Financial Statements*, IPSAS 7, *Investments in Associates*, and IPSAS 8, *Interests in Joint Ventures*. In January 2015 the IPSASB issued five new IPSASs, including IPSAS 38. These new IPSASs supersede IPSAS 6, IPSAS 7, and IPSAS 8.

Significant Judgments and Assumptions (paragraphs 12 to 14)

BC3. The IPSASB noted that paragraph 7 of IFRS 12,requires that an entity disclose information about significant judgments and assumptions it has made in determining the nature of its interest in another entity (for example, control, joint control or significant influence). Although the IPSASB agreed that users need information about how an entity has made these judgments, it noted that a public sector entity could be required to make many judgments and assumptions in relation to particular entities, and that the disclosure of such judgments and assumptions and changes in such judgments from period to period could result in unnecessary detail. The IPSASB also noted that, in the public sector, decisions about the reporting entity may be made having regard to frameworks developed in conjunction with other parties such as legislative bodies or oversight committees. The assessments made in respect of the classification of certain types of entities as controlled entities, jointly controlled entities, or entities subject to significant influence may be recorded in public documents other than the financial statements. The IPSASB therefore agreed to require that an entity disclose the methodology used to decide the existence or absence of control, joint control of an arrangement or significant influence, either in the financial statements themselves or by way of reference to another publicly available document.

Definition of Structured Entity (paragraphs 7 and AG20 to AG23)

BC4. The IPSASB noted that the definition of “structured entity” in IFRS 12 focusses on voting or similar rights, which tend to occur less frequently or have less significance in the public sector than in the private sector. However, the IPSASB agreed that it was still appropriate to refer to voting or similar rights in the definition of a structured entity because voting or similar rights may be the predominant way in which a public sector entity establishes control over another entity. The IPSASB decided to modify the definition of a structured entity to highlight that they occur when the conventional ways in which an entity is controlled are not the dominant factors in deciding who controls the entity and encompass the broader range of circumstances that occur in the public sector.

BC5. The IPSASB identified administrative arrangements and statutory provisions (legislation) as common means by which control may be determined for many public sector entities. Accordingly, the IPSASB took the view that the reference to “similar rights” in the definition of structured entity should encompass administrative arrangements and statutory provisions. Thus, the ED proposed that entities for which administrative arrangements or statutory provisions are dominant factors in determining control of the entity would not be structured entities. The IPSASB considers that the disclosures required of structured entities are appropriate, but that in order to be useful they need to be focused on a limited class of entities (consistent with the intention of the IASB’s requirements in relation to entities applying IFRS 12).

BC6. Some respondents to ED 52 were concerned that the definition of a structured entity could be read as suggesting that an entity was operating in an unauthorized way or in contravention of laws. The IPSASB noted that this was not its intention and reviewed the definition of structured entities to see if any clarification was required. The IPSASB noted that the definition does not suggest that a structured entity would not be required to comply with relevant statutes or administrative arrangements. Rather the definition allows for the possibility that a small group of entities may have been established under different arrangements from the arrangements commonly used to establish similar entities.

Investment Entities (paragraphs 27 to 34)

BC7. The IPSASB considered the investment entity disclosures required by IFRS 12 and concluded that those disclosures were particularly appropriate in the public sector context. The IPSASB noted that, as a consequence of the requirements in IPSAS 35 most public sector entities with investment entities would be required to make these disclosures.

BC8. The IPSASB considered whether a non-investment controlling entity accounting for investment entities at fair value should be required to make any additional disclosures. The IPSASB considered that the disclosures required in relation to investment entities were appropriate and should also be provided in the consolidated financial statements of a controlling entity with investment entities.

Non-quantifiable Ownership Interests (paragraphs 49 and 50)

BC9. The scope of IPSAS 36, *Investments in Associates and Joint Ventures*, is limited to "quantifiable ownership interests". The IPSASB noted that respondents supported this proposal, but considered that disclosure of information about an entity's non-quantifiable ownership interests in other entities would be appropriate. The IPSASB agreed to require, in this Standard, disclosure of information about non-quantifiable ownership interests.

Controlling Interests Acquired with the Intention of Disposal (paragraphs 50 to 57)

BC10. Some respondents to ED 52 proposed that the IPSASB require disclosures about temporary control (either by developing a standard based on IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, or by adding disclosures to this Standard). The IPSASB considered, and rejected, the idea of requiring disclosure of all controlled investments held for sale on the grounds that it was too broad. Nevertheless, the IPSASB agreed that some disclosure about controlling interests intended to be held for a limited time could be of interest to users. For example, the IPSASB considered that users would be interested in information about interventions to prevent the consequences of the failure of an entity, or acquisitions of entities which will subsequently be redistributed to achieve policy objectives. The IPSASB agreed that its objective was to require disclosure of information about controlling interests where there was an active intention to dispose of the interest, both at the time of the acquisition and at the reporting date.

BC11. In considering the information to be disclosed the IPSASB agreed that the requirements should be general in nature. The IPSASB acknowledged that the circumstances in which a controlling interest is acquired or disposed of could vary widely (for example, a controlling interest might be acquired by virtue of providing guarantees).In addition, entities might wish to provide information about the transactions or events giving rise to such controlling interests, and the IPSASB did not wish to be unnecessarily prescriptive about the type of information that should be provided. The IPSASB therefore agreed to require disclosures to assist users to understand the impact of consolidating such controlling interests on the consolidated financial statements by reference to the effect on the main aspects of the financial statements.

BC12. The IPSASB acknowledged that the expected method of disposal might be under consideration at the reporting date and that plans might change from one period to another. It also acknowledged that disposal might occur in stages. The IPSASB therefore agreed to require disclosure of the "current status of the approach to disposal".

BC13. The IPSASB considered whether to limit the disclosures to situations where control was expected to exist for a specified time period, such as one or two years. The IPSASB decided not to specify a time period. It considered that limiting the disclosures to controlling interests and situations where there was still an active intention to dispose of the interest would lead to informative disclosures without overwhelming readers with too much detail.

Revision of IPSAS 38 as a result of the IPSASB's *The Applicability of IPSASs*, issued in April 2016

BC14. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:

(a) Removes the standard paragraphs about the applicability of IPSASs to "public sector entities other than GBEs" from the scope section of each Standard;

(b) Replaces the term "GBE" with the term "commercial public sector entities", where appropriate; and

(c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.

Comparison with IFRS 12

IPSAS 38, *Disclosure of Interests in Other Entities* is drawn primarily from IFRS 12, *Disclosure of Interests in Other Entities* (issued in 2011, including amendments up to December 31, 2014). At the time of issuing this Standard, the IPSASB has not considered the applicability to public sector entities of IFRS 9, *Financial Instruments*. References to IFRS 9 in IFRS 12 are therefore replaced by references to the IPSASs dealing with financial instruments.

The main differences between IPSAS 38 and IFRS 12 are as follows:

- IPSAS 38 uses different terminology, in certain instances, from IFRS 12. The most significant examples are the use of the terms "net assets/equity," "economic entity," "controlling entity," "controlled entity", "revenue" in IPSAS 38. The equivalent terms in IFRS 12 are "equity," "group," "parent," "subsidiary" and "income."
- The definition of a structured entity in IPSAS 38 acknowledges the differing ways in which control may be obtained in the public sector.
- IPSAS 38 requires that a controlling entity that controls an investment entity, and is not itself an investment entity,disclose information in respect of unconsolidated investment entities. IFRS 12 does not require such disclosures by a controlling entity that controls an investment entity, and is not itself an investment entity because IFRS 10 requires that such a controlling entity consolidate controlled investment entities.
- IPSAS 38 requires the disclosure of information about non-quantifiable ownership interests. IFRS 12 does not specify such disclosures.
- IPSAS 38 requires the disclosure of information about interests in entities that were acquired with the intention of disposal and which are still held for disposal. IFRS 12 does not specify such disclosures. However, IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* requires disclosures about non-current assets held for sale.

IPSAS 39—EMPLOYEE BENEFITS

Acknowledgment

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IPSAS 39—EMPLOYEE BENEFITS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 39, *Employee Benefits* was issued in July 2016.

Since then, IPSAS 39 has been amended by the following IPSASs:

- *Improvements to IPSAS 2021* (issued January 2022)
- *Improvements to IPSAS 2018* (issued October 2018)

Table of Amended Paragraphs in IPSAS 39

Paragraph Affected	How Affected	Affected By
3	Amended	Improvements to IPSAS January 2022
4	Amended	Improvements to IPSAS January 2022
59	Amended	Improvements to IPSAS October 2018
101	Amended	Improvements to IPSAS October 2018
103A	New	Improvements to IPSAS October 2018
122	Amended	Improvements to IPSAS October 2018
Heading above paragraph 124A	New	Improvements to IPSAS October 2018
124A	New	Improvements to IPSAS October 2018
125	Amended	Improvements to IPSAS October 2018
125A	New	Improvements to IPSAS October 2018
127	Amended	Improvements to IPSAS October 2018
128	Amended	Improvements to IPSAS October 2018
159	Amended	Improvements to IPSAS October 2018
176A	New	Improvements to IPSAS October 2018
176B	New	Improvements to IPSAS January 2022
BC24	New	Improvements to IPSAS January 2022

IPSAS 39—EMPLOYEE BENEFITS

CONTENTS

International Public Sector Accounting Standard 39, *Employee Benefits*, is set out in paragraphs 1–178. All the paragraphs have equal authority. IPSAS 39 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting and disclosure for employee benefits. The Standard requires an entity to recognize:

   (a) A liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

   (b) An expense when the entity consumes the economic benefits or service potential arising from service provided by an employee in exchange for employee benefits.

Scope

2. **This Standard shall be applied by an employer in accounting for all employee benefits, except share-based transactions (see the relevant international or national accounting standard dealing with share-based transactions).**

3. This Standard does not deal with reporting by employee retirement benefit plans (see the relevant international or national accounting standard dealing with employee retirement benefit plans). This Standard does not deal with benefits provided by social security programs that are not consideration in exchange for service rendered by employees or past employees of public sector entities.

4. The employee benefits to which this Standard applies include those provided:

   (a) Under formal plans or other formal agreements between an entity and individual employees, groups of employees, or their representatives;

   (b) Under legislative requirements, or through industry arrangements, whereby entities are required to contribute to national, state, industry, or other multi-employer plans, or where entities are required to contribute to a social security program; or

   (c) By those informal practices that give rise to a constructive obligation. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees.

5. Employee benefits include:

   (a) Short-term employee benefits, such as the following, if expected to be settled wholly before twelve months after the end of the reporting period in which the employees render the related services:

      (i) Wages, salaries and social security contributions;

      (ii) Paid annual leave and paid sick leave;

      (iii) Profit-sharing and bonuses; and

      (iv) Non-monetary benefits (such as medical care, housing, cars and free or subsidized goods or services) for current employees;

   (b) Post-employment benefits, such as the following:

      (i) Retirement benefits (e.g., pensions and lump sum payments on retirement); and

      (ii) Other post-employment benefits, such as post-employment life insurance and post-employment medical care;

   (c) Other long-term employee benefits, such as the following:

      (i) Long-term paid absences such as long-service leave or sabbatical leave;

      (ii) Jubilee or other long-service benefits; and

      (iii) Long-term disability benefits; and

   (d) Termination benefits.

6. Employee benefits include benefits provided either to employees or to their dependants, and may be settled by payments (or the provision of goods or services) made either directly to the employees, to their spouses, children, or other dependants, or to others, such as insurance companies.

7. An employee may provide services to an entity on a full-time, part-time, permanent, casual, or temporary basis. For the purpose of this Standard, employees include key management personnel as defined in IPSAS 20, *Related Party Disclosures*.

Definitions

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

Definitions of Employee Benefits

Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment.

Short-term employee benefits are employee benefits (other than termination benefits) that are due to be settled wholly before twelve months after the end of the reporting period in which the employees render the related service.

Post-employment benefits are employee benefits (other than termination benefits and short-term employee benefits) that are payable after the completion of employment.

Other long-term employee benefits are all employee benefits other than short-term employee benefits, post-employment benefits and termination benefits.

Termination benefits are employee benefits provided in exchange for the termination of an employee's employment as a result of either:

(a) **An entity's decision to terminate an employee's employment before the normal retirement date; or**

(b) **An employee's decision to accept an offer of benefits in exchange for the termination of employment.**

Definitions Relating to Classification of Plans

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

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

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

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

(a) **Pool the assets contributed by various entities that are not under common control; and**

(b) **Use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees.**

State plans are plans established by legislation that operate as if they are multi-employer plans for all entities in economic categories laid down in legislation.

Definitions Relating to the Net Defined Benefit Liability (Asset)

The net defined benefit liability (asset) is the deficit or surplus, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling.

The deficit or surplus is:

(a) **The present value of the defined benefit obligation less**

(b) **The fair value of plan assets (if any).**

The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

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

Plan assets comprise:

(a) **Assets held by a long-term employee benefit fund; and**

(b) **Qualifying insurance policies.**

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

(a) **Are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and**

(b) **Are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either:**

  (i) **The remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or**

  (ii) **The assets are returned to the reporting entity to reimburse it for employee benefits already paid.**

A qualifying insurance policy is an insurance policy[1] issued by an insurer that is not a related party (as defined in IPSAS 20) of the reporting entity, if the proceeds of the policy:

(a) **Can be used only to pay or fund employee benefits under a defined benefit plan; and**

(b) **Are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:**

  (i) **The proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or**

  (ii) **The proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.**

Definitions Relating to Defined Benefit Cost

Service cost comprises:

(a) **Current service cost, which is the increase in the present value of the defined benefit obligation resulting from employee service in the current period;**

(b) **Past service cost, which is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or a curtailment (a significant reduction by the entity in the number of employees covered by a plan); and**

(c) **Any gain or loss on settlement.**

Net interest on the net defined benefit liability (asset) is the change during the period in the net defined benefit liability (asset) that arises from the passage of time.

Remeasurements of the net defined benefit liability (asset) comprise:

(a) **Actuarial gains and losses;**

(b) **The return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and**

(c) **Any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset).**

Actuarial gains and losses are changes in the present value of the defined benefit obligation resulting from:

(a) **Experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and**

(b) **The effects of changes in actuarial assumptions.**

[1] A qualifying insurance policy is not necessarily an insurance contract (see the relevant international or national standard dealing with insurance contracts).

The return on plan assets is interest, dividends or similar distributions and other revenue derived from the plan assets, together with realized and unrealized gains or losses on the plan assets, less:

(a) **Any costs of managing the plan assets; and**

(b) **Any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the present value of the defined benefit obligation.**

A settlement is a transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that is set out in the terms of the plan and included in the actuarial assumptions.

Short-Term Employee Benefits

9. Short-term employee benefits include items such as the following, if expected to be settled wholly before twelve months after the end of the reporting period in which the employees render the related services:

(a) Wages, salaries, and social security contributions;

(b) Paid annual leave and paid sick leave;

(c) Profit-sharing and bonuses; and

(d) Nonmonetary benefits (such as medical care, housing, cars, and free or subsidized goods or services) for current employees.

10. An entity need not reclassify a short-term employee benefit if the entity's expectations of the timing of settlement change temporarily. However, if the characteristics of the benefit change (such as a change from a non-accumulating benefit to an accumulating benefit) or if a change in expectations of the timing of settlement is not temporary, then the entity considers whether the benefit still meets the definition of short-term employee benefits.

Recognition and Measurement

All Short-Term Employee Benefits

11. **When an employee has rendered service to an entity during an accounting period, the entity shall recognize the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service:**

(a) **As a liability (accrued expense), after deducting any amount already paid. If the amount already paid exceeds the undiscounted amount of the benefits, an entity shall recognize that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund.**

(b) **As an expense, unless another Standard requires or permits the inclusion of the benefits in the cost of an asset (see, for example, IPSAS 12, *Inventories*, and IPSAS 17, *Property, Plant, and Equipment*).**

12. **Paragraphs 13, 16, and 19 explain how an entity shall apply paragraph 11 to short-term employee benefits in the form of paid absences and profit-sharing and bonus plans.**

Short-Term Paid Absences

13. **An entity shall recognize the expected cost of short-term employee benefits in the form of paid absences under paragraph 11 as follows:**

(a) **In the case of accumulating paid absences, when the employees render service that increases their entitlement to future paid absences; and**

(b) **In the case of non-accumulating paid absences, when the absences occur.**

14. An entity may pay employees for absence for various reasons, including holidays, sickness and short-term disability, maternity or paternity, jury service, and military service. Entitlement to paid absences falls into two categories:

(a) Accumulating; and

(b) Non-accumulating.

15. Accumulating paid absences are those that are carried forward and can be used in future periods if the current period's entitlement is not used in full. Accumulating paid absences may be either vesting (in other words, employees are entitled to a cash payment for unused entitlement on leaving the entity) or non-vesting (when employees are not entitled to a

cash payment for unused entitlement on leaving). An obligation arises as employees render service that increases their entitlement to future paid absences. The obligation exists, and is recognized, even if the paid absences are nonvesting, although the possibility that employees may leave before they use an accumulated nonvesting entitlement affects the measurement of that obligation.

16. **An entity shall measure the expected cost of accumulating paid absences as the additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period.**

17. The method specified in the previous paragraph measures the obligation at the amount of the additional payments that are expected to arise solely from the fact that the benefit accumulates. In many cases, an entity may not need to make detailed computations to estimate that there is no material obligation for unused paid absences. For example, a sick leave obligation is likely to be material only if there is a formal or informal understanding that unused paid sick leave may be taken as paid annual leave.

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

Profit-Sharing and Bonus Plans

19. **An entity shall recognize the expected cost of profit-sharing and bonus payments under paragraph 11 when, and only when:**

    (a) **The entity has a present legal or constructive obligation to make such payments as a result of past events; and**

    (b) **A reliable estimate of the obligation can be made.**

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

20. In the public sector, some entities have bonus plans that are related to service delivery objectives or aspects of financial performance. Under such plans, employees receive specified amounts, dependent on an assessment of their contribution to the achievement of the objectives of the entity or a segment of the entity. In some cases, such plans may be for groups of employees, such as when performance is evaluated for all or some employees in a particular segment, rather than on an individual basis. Because of the objectives of public sector entities, profit-sharing plans are far less common in the public sector than for profit-oriented entities. However, they are likely to be an aspect of employee remuneration in segments of public sector entities that operate on a commercial basis. Some public sector entities may not operate profit-sharing schemes, but may evaluate performance against financially based measures such as the generation of revenue streams and the achievement of budgetary targets. Some bonus plans may entail payments to all employees who rendered employment services in a reporting period, even though they may have left the entity before the end of the reporting period. However, under other bonus plans, employees receive payments only if they remain with the entity for a specified period, for example, a requirement that employees render services for the whole of the reporting period. Such plans create a constructive obligation as employees render service that increases the amount to be paid if they remain in service until the end of the specified period. The measurement of such constructive obligations reflects the possibility that some employees may leave without receiving profit-sharing payments. Paragraph 22 provides further conditions that are to be satisfied before an entity can recognize the expected cost of performance-related payments, bonus payments, and profit-sharing payments.

21. An entity may have no legal obligation to pay a bonus. Nevertheless, in some cases, an entity has a practice of paying bonuses. In such cases, the entity has a constructive obligation because the entity has no realistic alternative but to pay the bonus. The measurement of the constructive obligation reflects the possibility that some employees may leave without receiving a bonus.

22. An entity can make a reliable estimate of its legal or constructive obligation under a performance-related payment scheme, bonus plan, or profit-sharing scheme when, and only when:

    (a) The formal terms of the plan contain a formula for determining the amount of the benefit;

    (b) The entity determines the amounts to be paid before the financial statements are authorized for issue; or

    (c) Past practice gives clear evidence of the amount of the entity's constructive obligation.

23. An obligation under profit-sharing plans and bonus plans results from employee service and not from a transaction with the entity's owners. Therefore, an entity recognizes the cost of profit-sharing and bonus plans not as a distribution of profit but as an expense.

24. If profit-sharing and bonus payments are not expected to be settled wholly before twelve months after the end of the reporting period in which the employees render the related service, those payments are other long-term employee benefits (see paragraphs 155–161).

Disclosure

25. Although this Standard does not require specific disclosures about short-term employee benefits, other Standards may require disclosures. For example, IPSAS 20 requires disclosures of the aggregate remuneration of key management personnel and IPSAS 1, *Presentation of Financial Statements* requires the disclosure of information about employee benefits expense.

Post-employment Benefits—Distinction between Defined Contribution Plans and Defined Benefit Plans

26. Post-employment benefits include items such as the following:

    (a) Retirement benefits (e.g., pensions and lump sum payments on retirement); and

    (b) Other post-employment benefits, such as post-employment life insurance, and post-employment medical care.

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

27. Post-employment benefit plans are classified as either defined contribution plans or defined benefit plans, depending on the economic substance of the plan, as derived from its principal terms and conditions.

28. Under defined contribution plans the entity's legal or constructive obligation is limited to the amount that it agrees to contribute to the fund. Thus, the amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by an entity (and perhaps also the employee) to a post-employment benefit plan or to an insurance company, together with investment returns arising from the contributions. In consequence, actuarial risk (that benefits will be less than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall, in substance, on the employee.

29. Examples of cases where an entity's obligation is not limited to the amount that it agrees to contribute to the fund are when the entity has a legal or constructive obligation through:

    (a) A plan benefit formula that is not linked solely to the amount of contributions and requires the entity to provide further contributions if assets are insufficient to meet the benefits in the plan benefit formula;

    (b) A guarantee, either indirectly through a plan or directly, of a specified return on contributions; or

    (c) Those informal practices that give rise to a constructive obligation. For example, a constructive obligation may arise where an entity has a history of increasing benefits for former employees to keep pace with inflation, even where there is no legal obligation to do so.

30. Under defined benefit plans:

    (a) The entity's obligation is to provide the agreed benefits to current and former employees; and

    (b) Actuarial risk (that benefits will cost more than expected) and investment risk fall, in substance, on the entity. If actuarial or investment experience are worse than expected, the entity's obligation may be increased.

31. Paragraphs 32–51 explain the distinction between defined contribution plans and defined benefit plans in the context of multi-employer plans, defined benefit plans that share risks between entities under common control, state plans, and insured benefits.

Multi-Employer Plans

32. **An entity shall classify a multi-employer plan as a defined contribution plan or a defined benefit plan under the terms of the plan (including any constructive obligation that goes beyond the formal terms).**

33. **If an entity participates in a multi-employer defined benefit plan, unless paragraph 34 applies, it shall:**

    (a) **Account for its proportionate share of the defined benefit obligation, plan assets and cost associated with the plan in the same way as for any other defined benefit plan; and**

    (b) **Disclose the information required by paragraphs 137–150 (excluding paragraph 150(d)).**

34. **When sufficient information is not available to use defined benefit accounting for a multi-employer defined benefit plan, an entity shall:**

    (a) **Account for the plan in accordance with paragraphs 53 and 54 as if it were a defined contribution plan; and**

    (b) **Disclose the information required by paragraph 150.**

35. One example of a multi-employer defined benefit plan is one where:

    (a) The plan is financed on a pay-as-you-go basis: contributions are set at a level that is expected to be sufficient to pay the benefits falling due in the same period; and future benefits earned during the current period will be paid out of future contributions; and

    (b) Employees' benefits are determined by the length of their service and the participating entities have no realistic means of withdrawing from the plan without paying a contribution for the benefits earned by employees up to the date of withdrawal. Such a plan creates actuarial risk for the entity: if the ultimate cost of benefits already earned at the end of the reporting period is more than expected, the entity will have to either increase its contributions or persuade employees to accept a reduction in benefits. Therefore, such a plan is a defined benefit plan.

36. Where sufficient information is available about a multi-employer defined benefit plan, an entity accounts for its proportionate share of the defined benefit obligation, plan assets, and post-employment benefit cost associated with the plan in the same way as for any other defined benefit plan. However, an entity may not be able to identify its share of the underlying financial position and performance of the plan with sufficient reliability for accounting purposes. This may occur if:

    (a) The plan exposes the participating entities to actuarial risks associated with the current and former employees of other entities, with the result that there is no consistent and reliable basis for allocating the obligation, plan assets, and cost to individual entities participating in the plan; or

    (b) The entity does not have access to sufficient information about the plan that satisfies the requirements of this Standard.

    In those cases, an entity accounts for the plan as if it were a defined contribution plan, and discloses the additional information required by paragraph 150.

37. There may be a contractual agreement between the multi-employer plan and its participants that determines how the surplus in the plan will be distributed to the participants (or the deficit funded). A participant in a multi-employer plan with such an agreement that accounts for the plan as a defined contribution plan in accordance with paragraph 34 shall recognize the asset or liability that arises from the contractual agreement, and the resulting revenue or expense in surplus or deficit.

38. Multi-employer plans are distinct from group administration plans. A group administration plan is merely an aggregation of single employer plans combined to allow participating employers to pool their assets for investment purposes and reduce investment management and administration costs, but the claims of different employers are segregated for the sole benefit of their own employees. Group administration plans pose no particular accounting problems because information is readily available to treat them in the same way as any other single employer plan and because such plans do not expose the participating entities to actuarial risks associated with the current and former employees of other entities. The definitions in this Standard require an entity to classify a group administration plan as a defined contribution plan or a defined benefit plan in accordance with the terms of the plan (including any constructive obligation that goes beyond the formal terms).

39. **In determining when to recognize, and how to measure, a liability relating to the wind-up of a multi-employer defined benefit plan, or the entity's withdrawal from a multi-employer defined benefit plan, an entity shall apply IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.**

Defined Benefit Plans that Share Risks between Entities under Common Control

40. Defined benefit plans that share risks between various entities under common control, for example, controlling and controlled entities, are not multi-employer plans.

41. An entity participating in such a plan obtains information about the plan as a whole, measured in accordance with this Standard on the basis of assumptions that apply to the plan as a whole. If there is a contractual agreement, binding

arrangement, or stated policy for charging the net defined benefit cost for the plan as a whole measured in accordance with this Standard to individual entities within the economic entity, the entity shall, in its separate or individual financial statements, recognize the net defined benefit cost so charged. If there is no such agreement, arrangement, or policy, the net defined benefit cost shall be recognized in the separate or individual financial statements of the entity that is legally the sponsoring employer for the plan. The other entities shall, in their separate or individual financial statements, recognize a cost equal to their contribution payable for the period.

42. There are cases in the public sector where a controlling entity and one or more controlled entities participate in a defined benefit plan. Unless there is a contractual agreement, binding arrangement, or stated policy, as specified in paragraph 41, the controlled entity accounts on a defined contribution basis and the controlling entity accounts on a defined benefit basis in its consolidated financial statements. The controlled entity also discloses that it accounts on a defined contribution basis in its separate financial statements. A controlled entity that accounts on a defined contribution basis also provides details of the controlling entity, and states that, in the controlling entity's consolidated financial statements, accounting is on a defined benefit basis. The controlled entity also makes the disclosures required in paragraph 151.

43. **Participation in such a plan is a related party transaction for each individual entity. An entity shall therefore, in its separate or individual financial statements, disclose the information required by paragraph 151.**

State Plans

44. **An entity shall account for a state plan in the same way as for a multi-employer plan (see paragraphs 32–39).**

45. State plans are established by legislation to cover all entities (or all entities in a particular category, for example, a specific industry) and are operated by national, state, or local government or by another body (for example, an agency created specifically for this purpose). This Standard deals only with employee benefits of the entity, and does not address accounting for any obligations under state plans related to employees and past employees of entities that are not controlled by the reporting entity. While governments may establish state plans and provide benefits to employees of private sector entities and/or self-employed individuals, obligations arising in respect of such plans are not addressed in this Standard. Some plans established by an entity provide both compulsory benefits, as a substitute for benefits that would otherwise be covered under a state plan, and additional voluntary benefits. Such plans are not state plans.

46. Many state plans are funded on a pay-as-you-go basis: contributions are set at a level that is expected to be sufficient to pay the required benefits falling due in the same period; future benefits earned during the current period will be paid out of future contributions. Entities covered by state plans account for those plans as either defined contribution or defined benefit plans. The accounting treatment depends upon whether the entity has a legal or constructive obligation to pay future benefits. If an entity's only obligation is to pay the contributions as they fall due, and the entity has no obligation to pay future benefits, it accounts for that state plan as a defined contribution plan.

47. A state plan may be classified as a defined contribution plan by a controlled entity. However, it is a rebuttable presumption that the state plan will be characterized as a defined benefit plan by the controlling entity. Where that presumption is rebutted the state plan is accounted for as a defined contribution plan.

Insured Benefits

48. **An entity may pay insurance premiums to fund a post-employment benefit plan. The entity shall treat such a plan as a defined contribution plan unless the entity will have (either directly, or indirectly through the plan) a legal or constructive obligation either:**

    (a) **To pay the employee benefits directly when they fall due; or**

    (b) **To pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods.**

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

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

50. Where an entity funds a post-employment benefit obligation by contributing to an insurance policy under which the entity (either directly, indirectly through the plan, through the mechanism for setting future premiums, or through a related party relationship with the insurer) retains a legal or constructive obligation, the payment of the premiums does not amount to a defined contribution arrangement. It follows that the entity:

(a) Accounts for a qualifying insurance policy as a plan asset (see paragraph 8); and

(b) Recognizes other insurance policies as reimbursement rights (if the policies satisfy the criteria in paragraph 118).

51. Where an insurance policy is in the name of a specified plan participant or a group of plan participants, and the entity does not have any legal or constructive obligation to cover any loss on the policy, the entity has no obligation to pay benefits to the employees, and the insurer has sole responsibility for paying the benefits. The payment of fixed premiums under such contracts is, in substance, the settlement of the employee benefit obligation, rather than an investment to meet the obligation. Consequently, the entity no longer has an asset or a liability. Therefore, an entity treats such payments as contributions to a defined contribution plan.

Post-Employment Benefits—Defined Contribution Plans

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

Recognition and Measurement

53. **When an employee has rendered service to an entity during a period, the entity shall recognize the contribution payable to a defined contribution plan in exchange for that service:**

(a) **As a liability (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the end of the reporting period, an entity shall recognize that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and**

(b) **As an expense, unless another Standard requires or permits the inclusion of the contribution in the cost of an asset (see, for example, IPSAS 12 and IPSAS 17).**

54. **When contributions to a defined contribution plan are not expected to be settled wholly before twelve months after the end of the reporting period in which the employees render the related service, they shall be discounted using the discount rate specified in paragraph 85.**

Disclosure

55. **An entity shall disclose the amount recognized as an expense for defined contribution plans.**

56. Where required by IPSAS 20, an entity discloses information about contributions to defined contribution plans for key management personnel.

Post-Employment Benefits—Defined Benefit Plans

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

Recognition and Measurement

58. Defined benefit plans may be unfunded, or they may be wholly or partly funded by contributions by an entity, and sometimes its employees, into an entity, or fund, that is legally separate from the reporting entity and from which the employee benefits are paid. The payment of funded benefits when they fall due depends not only on the financial position and the investment performance of the fund but also on an entity's ability, and willingness, to make good any shortfall in the fund's assets. Therefore, the entity is, in substance, underwriting the actuarial and investment risks associated with the plan. Consequently, the expense recognized for a defined benefit plan is not necessarily the amount of the contribution due for the period.

59. Accounting by an entity for defined benefit plans involves the following steps:

(a) Determining the deficit or surplus. This involves:

(i) Using an actuarial technique, the projected unit credit method, to make a reliable estimate of the ultimate cost to the entity of the benefit that employees have earned in return for their service in the current and prior periods (see paragraphs 69–71). This requires an entity to determine how much benefit is attributable to the current and prior periods (see paragraphs 72–76), and to make estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries and medical costs) that will affect the cost of the benefit (see paragraphs 77–100);

(ii) Discounting that benefit in order to determine the present value of the defined benefit obligation and the current service cost (see paragraphs 69–71 and 85–88);

(iii) Deducting the fair value of any plan assets (see paragraphs 115–117) from the present value of the defined benefit obligation;

(b) Determining the amount of the net defined benefit liability (asset) as the amount of the deficit or surplus determined in (a), adjusted for any effect of limiting a net defined benefit asset to the asset ceiling (see paragraph 66).

(c) Determining amounts to be recognized in surplus or deficit:

(i) Current service cost (see paragraphs 72–76 and paragraph 124A).

(ii) Any past service cost and gain or loss on settlement (see paragraphs 101–114).

(iii) Net interest on the net defined benefit liability (asset) (see paragraphs 125–128).

(d) Determining the remeasurements of the net defined benefit liability (asset), to be recognized in net assets/equity, comprising:

(i) Actuarial gains and losses (see paragraphs 130 and 131);

(ii) Return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset) (see paragraph 132); and

(iii) Any change in the effect of the asset ceiling (see paragraph 66), excluding amounts included in net interest on the net defined benefit liability (asset).

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

60. **An entity shall determine the net defined benefit liability (asset) with sufficient regularity that the amounts recognized in the financial statements do not differ materially from the amounts that would be determined at the end of the reporting period.**

61. This Standard encourages, but does not require, an entity to involve a qualified actuary in the measurement of all material post-employment benefit obligations. For practical reasons, an entity may request a qualified actuary to carry out a detailed valuation of the obligation before the end of the reporting period. Nevertheless, the results of that valuation are updated for any material transactions and other material changes in circumstances (including changes in market prices and interest rates) up to the end of the reporting period.

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

Accounting for the Constructive Obligation

63. **An entity shall account not only for its legal obligation under the formal terms of a defined benefit plan, but also for any constructive obligation that arises from the entity's informal practices. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees.**

64. The formal terms of a defined benefit plan may permit an entity to terminate its obligation under the plan. Nevertheless, it is usually difficult for an entity to terminate its obligation under a plan (without payment) if employees are to be retained. Therefore, in the absence of evidence to the contrary, accounting for post-employment benefits assumes that an entity that is currently promising such benefits will continue to do so over the remaining working lives of employees.

Statement of Financial Position

65. **An entity shall recognize the net defined benefit liability (asset) in the statement of financial position**.

66. **When an entity has a surplus in a defined benefit plan, it shall measure the net defined benefit asset at the lower of:**

(a) **The surplus in the defined benefit plan; and**

(b) **The asset ceiling, determined using the discount rate specified in paragraph 85.**

67. A net defined benefit asset may arise where a defined benefit plan has been overfunded or where actuarial gains have arisen. An entity recognizes a net defined benefit asset in such cases because:

(a) The entity controls a resource, which is the ability to use the surplus to generate future benefits;

(b) That control is a result of past events (contributions paid by the entity and service rendered by the employee); and

(c) Future economic benefits are available to the entity in the form of a reduction in future contributions or a cash refund, either directly to the entity or indirectly to another plan in deficit. The asset ceiling is the present value of those future benefits.

Recognition and Measurement—Present Value of Defined Benefit Obligations and Current Service Cost

68. The ultimate cost of a defined benefit plan may be influenced by many variables, such as final salaries, employee turnover and mortality, employee contributions and medical cost trends. The ultimate cost of the plan is uncertain and this uncertainty is likely to persist over a long period of time. In order to measure the present value of the post-employment benefit obligations and the related current service cost, it is necessary:

(a) To apply an actuarial valuation method (see paragraphs 69–71);

(b) To attribute benefit to periods of service (see paragraphs 72–76); and

(c) To make actuarial assumptions (see paragraphs 77–100).

Actuarial Valuation Method

69. **An entity shall use the projected unit credit method to determine the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost.**

70. The projected unit credit method (sometimes known as the accrued benefit method prorated on service or as the benefit/years of service method) sees each period of service as giving rise to an additional unit of benefit entitlement (see paragraphs 72–76), and measures each unit separately to build up the final obligation (see paragraphs 77–100).

71. An entity discounts the whole of a post-employment benefit obligation, even if part of the obligation is expected to be settled before twelve months after the reporting period.

Attributing Benefit to Periods of Service

72. **In determining the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost, an entity shall attribute benefit to periods of service under the plan's benefit formula. However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an entity shall attribute benefit on a straight-line basis from:**

(a) **The date when service by the employee first leads to benefits under the plan (whether or not the benefits are conditional on further service) until**

(b) **The date when further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases.**

73. The projected unit credit method requires an entity to attribute benefit to the current period (in order to determine current service cost) and the current and prior periods (in order to determine the present value of defined benefit obligations). An entity attributes benefit to periods in which the obligation to provide post-employment benefits arises. That obligation arises as employees render services in return for post-employment benefits that an entity expects to pay in future reporting periods. Actuarial techniques allow an entity to measure that obligation with sufficient reliability to justify recognition of a liability.

74. Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words they are not vested). Employee service before the vesting date gives rise to a constructive obligation because, at the end of each successive reporting period, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced. In measuring its defined benefit obligation, an entity considers the probability that some employees may not satisfy any vesting requirements. Similarly, although some post-

employment benefits, for example, post-employment medical benefits, become payable only if a specified event occurs when an employee is no longer employed, an obligation is created when the employee renders service that will provide entitlement to the benefit if the specified event occurs. The probability that the specified event will occur affects the measurement of the obligation, but does not determine whether the obligation exists.

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

76. Where the amount of a benefit is a constant proportion of final salary for each year of service, future salary increases will affect the amount required to settle the obligation that exists for service before the end of the reporting period, but do not create an additional obligation. Therefore:

(a) For the purpose of paragraph 72(b), salary increases do not lead to further benefits, even though the amount of the benefits is dependent on final salary; and

(b) The amount of benefit attributed to each period is a constant proportion of the salary to which the benefit is linked.

Actuarial Assumptions

77. Actuarial assumptions shall be unbiased and mutually compatible.

78. Actuarial assumptions are an entity's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits. Actuarial assumptions comprise:

(a) Demographic assumptions about the future characteristics of current and former employees (and their dependants) who are eligible for benefits. Demographic assumptions deal with matters such as:

(i) Mortality (see paragraphs 83 and 84);

(ii) Rates of employee turnover, disability, and early retirement;

(iii) The proportion of plan members with dependants who will be eligible for benefits;

(iv) The proportion of plan members who will select each form of payment option available under the plan terms; and

(v) Claim rates under medical plans.

(b) Financial assumptions, dealing with items such as:

(i) The discount rate (see paragraphs 85–88);

(ii) Benefit levels, excluding any cost of the benefits to be met by employees, and future salary (see paragraphs 89–97);

(iii) In the case of medical benefits, future medical costs, including claim handling costs (i.e., the costs that will be incurred in processing and resolving claims, including legal and adjuster's fees) (see paragraphs 98–100); and

(iv) Taxes payable by the plan on contributions relating to service before the end of the reporting period or on benefits resulting from that service.

79. Actuarial assumptions are unbiased if they are neither imprudent nor excessively conservative.

80. Actuarial assumptions are mutually compatible if they reflect the economic relationships between factors such as inflation, rates of salary increase, and discount rates. For example, all assumptions that depend on a particular inflation level (such as assumptions about interest rates and salary and benefit increases) in any given future period assume the same inflation level in that period.

81. An entity determines the discount rate and other financial assumptions in nominal (stated) terms, unless estimates in real (inflation-adjusted) terms are more reliable, for example, in a hyperinflationary economy (see IPSAS 10, *Financial Reporting in Hyperinflationary Economies*), or where the benefit is index-linked, and there is a deep market in index-linked bonds of the same currency and term.

82. **Financial assumptions shall be based on market expectations, at the end of the reporting period, for the period over which the obligations are to be settled.**

Actuarial Assumptions: Mortality

83. **An entity shall determine its mortality assumptions by reference to its best estimate of the mortality of plan members both during and after employment.**

84. In order to estimate the ultimate cost of the benefit an entity takes into consideration expected changes in mortality, for example by modifying standard mortality tables with estimates of mortality improvements.

Actuarial Assumptions—Discount Rate

85. **The rate used to discount post-employment benefit obligations (both funded and unfunded) shall reflect the time value of money. The currency and term of the financial instrument selected to reflect the time value of money shall be consistent with the currency and estimated term of the post-employment benefit obligations.**

86. One actuarial assumption that has a material effect is the discount rate. The discount rate reflects the time value of money but not the actuarial or investment risk. Furthermore, the discount rate does not reflect the entity-specific credit risk borne by the entity's creditors, nor does it reflect the risk that future experience may differ from actuarial assumptions.

87. The discount rate reflects the estimated timing of benefit payments. In practice, an entity often achieves this by applying a single weighted average discount rate that reflects the estimated timing and amount of benefit payments, and the currency in which the benefits are to be paid.

88. An entity makes a judgment whether the discount rate that reflects the time value of money is best approximated by reference to market yields at the end of the reporting period on government bonds, high quality corporate bonds, or by another financial instrument. In some jurisdictions, market yields at the end of the reporting period on government bonds will provide the best approximation of the time value of money. However, there may be jurisdictions in which this is not the case, for example, jurisdictions where there is no deep market in government bonds, or in which market yields at the end of the reporting period on government bonds do not reflect the time value of money. In such cases, the reporting entity determines the rate by another method, such as by reference to market yields on high quality corporate bonds. There may also be circumstances where there is no deep market in government bonds or high quality corporate bonds with a sufficiently long maturity to match the estimated maturity of all the benefit payments. In such circumstances, an entity uses current market rates of the appropriate term to discount shorter term payments, and estimates the discount rate for longer maturities by extrapolating current market rates along the yield curve. The total present value of a defined benefit obligation is unlikely to be particularly sensitive to the discount rate applied to the portion of benefits that is payable beyond the final maturity of the available financial instrument, such as government bonds or corporate bonds.

Actuarial Assumptions—Salaries, Benefits and Medical Costs

89. **An entity shall measure its defined benefit obligations on a basis that reflects:**

    (a) **The benefits set out in the terms of the plan (or resulting from any constructive obligation that goes beyond those terms) at the end of the reporting period;**

    (b) **Any estimated future salary increases that affect the benefits payable;**

    (c) **The effect of any limit on the employer's share of the cost of the future benefits;**

    (d) **Contributions from employees or third parties that reduce the ultimate cost to the entity of those benefits; and**

    (e) **Estimated future changes in the level of any state benefits that affect the benefits payable under a defined benefit plan, if, and only if, either:**

        (i) **Those changes were enacted before the end of the reporting period; or**

        (ii) **Historical data, or other reliable evidence, indicate that those state benefits will change in some predictable manner, for example, in line with future changes in general price levels or general salary levels.**

90. Actuarial assumptions reflect future benefit changes that are set out in the formal terms of a plan (or a constructive obligation that goes beyond those terms) at the end of the reporting period. This is the case if, for example:

    (a) The entity has a history of increasing benefits, for example, to mitigate the effects of inflation, and there is no indication that this practice will change in the future;

(b) The entity is obliged, by either the formal terms of a plan (or a constructive obligation that goes beyond those terms) or legislation, to use any surplus in the plan for the benefit of plan participants (see paragraph 110(c)); or

(c) Benefits vary in response to a performance target or other criteria. For example, the terms of the plan may state that it will pay reduced benefits or require additional contributions from employees if the plan assets are insufficient. The measurement of the obligation reflects the best estimate of the effect of the performance target or other criteria.

91. Actuarial assumptions do not reflect future benefit changes that are not set out in the formal terms of the plan (or a constructive obligation) at the end of the reporting period. Such changes will result in:

(a) Past service cost, to the extent that they change benefits for service before the change; and

(b) Current service cost for periods after the change, to the extent that they change benefits for service after the change.

92. Estimates of future salary increases take account of inflation, seniority, promotion, and other relevant factors, such as supply and demand in the employment market.

93. Some defined benefit plans limit the contributions that an entity is required to pay. The ultimate cost of the benefits takes account of the effect of a limit on contributions. The effect of a limit on contributions is determined over the shorter of:

(a) The estimated life of the entity; and

(b) The estimated life of the plan.

94. Some defined benefit plans require employees or third parties to contribute to the cost of the plan. Contributions by employees reduce the cost of the benefits to the entity. An entity considers whether third-party contributions reduce the cost of the benefits to the entity, or are a reimbursement right as described in paragraph 118. Contributions by employees or third parties are either set out in the formal terms of the plan (or arise from a constructive obligation that goes beyond those terms), or are discretionary. Discretionary contributions by employees or third parties reduce service cost upon payment of these contributions to the plan.

95. Contributions from employees or third parties set out in the formal terms of the plan either reduce service cost (if they are linked to service), or affect remeasurements of the net defined benefit liability (asset) (if they are not linked to service). An example of contributions that are not linked to service is when the contributions are required to reduce a deficit arising from losses on plan assets or from actuarial losses. If contributions from employees or third parties are linked to service, those contributions reduce the service cost as follows:

(a) If the amount of the contributions is dependent on the number of years of service, an entity shall attribute the contributions to periods of service using the same attribution method required by paragraph 72 for the gross benefit (i.e., either using the plan's contribution formula or on a straight-line basis); or

(b) If the amount of the contributions is independent of the number of years of service, the entity is permitted to recognize such contributions as a reduction of the service cost in the period in which the related service is rendered. Examples of contributions that are independent of the number of years of service include those that are a fixed percentage of the employee's salary, a fixed amount throughout the service period or dependent on the employee's age.

Paragraph AG13 provides related application guidance.

96. For contributions from employees or third parties that are attributed to periods of service in accordance with paragraph 95(a), changes in the contributions result in:

(a) Current and past service cost (if those changes are not set out in the formal terms of a plan and do not arise from a constructive obligation); or

(b) Actuarial gains and losses (if those changes are set out in the formal terms of a plan, or arise from a constructive obligation).

97. Some post-employment benefits are linked to variables such as the level of benefit entitlements from social security pensions or state medical care. The measurement of such benefits reflects the best estimate of such variables, based on historical data and other reliable evidence.

98. **Assumptions about medical costs shall take account of estimated future changes in the cost of medical services, resulting from both inflation and specific changes in medical costs.**

99. Measurement of post-employment medical benefits requires assumptions about the level and frequency of future claims and the cost of meeting those claims. An entity estimates future medical costs on the basis of historical data about the

entity's own experience, supplemented where necessary by historical data from other entities, insurance companies, medical providers, or other sources. Estimates of future medical costs consider the effect of technological advances, changes in health care utilization or delivery patterns, and changes in the health status of plan participants.

100. The level and frequency of claims is particularly sensitive to the age, health status, and gender of employees (and their dependants), and may be sensitive to other factors such as geographical location. Therefore, historical data are adjusted to the extent that the demographic mix of the population differs from that of the population used as a basis for the data. They are also adjusted where there is reliable evidence that historical trends will not continue.

Past Service Cost and Gains and Losses on Settlement

101. **When determining past service cost, or a gain or loss on settlement, an entity shall remeasure the net defined benefit liability (asset) using the current fair value of plan assets and current actuarial assumptions (including current market interest rates and other current market prices), reflecting:**

   (a) **The benefits offered under the plan and the plan assets before the plan amendment, curtailment or settlement; and**

   (b) **The benefits offered under the plan and the plan assets after the plan amendment, curtailment or settlement.**

102. An entity need not distinguish between past service cost resulting from a plan amendment, past service cost resulting from a curtailment and a gain or loss on settlement if these transactions occur together. In some cases, a plan amendment occurs before a settlement, such as when an entity changes the benefits under the plan and settles the amended benefits later. In those cases an entity recognizes past service cost before any gain or loss on settlement.

103. A settlement occurs together with a plan amendment and curtailment if a plan is terminated with the result that the obligation is settled and the plan ceases to exist. However, the termination of a plan is not a settlement if the plan is replaced by a new plan that offers benefits that are, in substance, the same.

103A. When a plan amendment, curtailment or settlement occurs, an entity shall recognize and measure any past service cost, or a gain or loss on settlement, in accordance with paragraphs 101–103 and paragraphs 104–114. In doing so, an entity shall not consider the effect of the asset ceiling. An entity shall then determine the effect of the asset ceiling after the plan amendment, curtailment or settlement and shall recognize any change in that effect in accordance with paragraph 59(d).

Past Service Cost

104. Past service cost is the change in the present value of the defined benefit obligation resulting from a plan amendment or curtailment.

105. **An entity shall recognize past service cost as an expense at the earlier of the following dates:**

   (a) **When the plan amendment or curtailment occurs; and**

   (b) **When the entity recognizes related restructuring costs (see IPSAS 19) or termination benefits (see paragraph 168).**

106. A plan amendment occurs when an entity introduces, or withdraws, a defined benefit plan or changes the benefits payable under an existing defined benefit plan.

107. A curtailment occurs when an entity significantly reduces the number of employees covered by a plan. A curtailment may arise from an isolated event, such as the closing of a plant, discontinuance of an operation or termination or suspension of a plan.

108. Past service cost may be either positive (when benefits are introduced or changed so that the present value of the defined benefit obligation increases) or negative (when benefits are withdrawn or changed so that the present value of the defined benefit obligation decreases).

109. Where an entity reduces benefits payable under an existing defined benefit plan and, at the same time, increases other benefits payable under the plan for the same employees, the entity treats the change as a single net change.

110. Past service cost excludes:

   (a) The effect of differences between actual and previously assumed salary increases on the obligation to pay benefits for service in prior years (there is no past service cost because actuarial assumptions allow for projected salaries);

(b) Underestimates and overestimates of discretionary pension increases when an entity has a constructive obligation to grant such increases (there is no past service cost because actuarial assumptions allow for such increases);

(c) Estimates of benefit improvements that result from actuarial gains or from the return on plan assets that have been recognized in the financial statements if the entity is obliged, by either the formal terms of a plan (or a constructive obligation that goes beyond those terms) or legislation, to use any surplus in the plan for the benefit of plan participants, even if the benefit increase has not yet been formally awarded (there is no past service cost because the resulting increase in the obligation is an actuarial loss, see paragraph 90); and

(d) The increase in vested benefits (i.e., benefits that are not conditional on future employment, see paragraph 74) when, in the absence of new or improved benefits, employees complete vesting requirements (there is no past service cost because the entity recognized the estimated cost of benefits as current service cost as the service was rendered).

Gains and Losses on Settlement

111. The gain or loss on a settlement is the difference between:

(a) The present value of the defined benefit obligation being settled, as determined on the date of settlement; and

(b) The settlement price, including any plan assets transferred and any payments made directly by the entity in connection with the settlement.

112. **An entity shall recognize a gain or loss on the settlement of a defined benefit plan when the settlement occurs.**

113. A settlement occurs when an entity enters into a transaction that eliminates all further legal or constructive obligation for part or all of the benefits provided under a defined benefit plan (other than a payment of benefits to, or on behalf of, employees in accordance with the terms of the plan and included in the actuarial assumptions). For example, a one-off transfer of significant employer obligations under the plan to an insurance company through the purchase of an insurance policy is a settlement; a lump sum cash payment, under the terms of the plan, to plan participants in exchange for their rights to receive specified post-employment benefits is not.

114. In some cases, an entity acquires an insurance policy to fund some or all of the employee benefits relating to employee service in the current and prior periods. The acquisition of such a policy is not a settlement if the entity retains a legal or constructive obligation (see paragraph 48) to pay further amounts if the insurer does not pay the employee benefits specified in the insurance policy. Paragraphs 118–121 deal with the recognition and measurement of reimbursement rights under insurance policies that are not plan assets.

Recognition and Measurement—Plan Assets

Fair Value of Plan Assets

115. The fair value of any plan assets is deducted from the present value of the defined benefit obligation in determining the deficit or surplus.

116. Plan assets exclude unpaid contributions due from the reporting entity to the fund, as well as any non-transferable financial instruments issued by the entity and held by the fund. Plan assets are reduced by any liabilities of the fund that do not relate to employee benefits, for example, trade and other payables and liabilities resulting from derivative financial instruments.

117. Where plan assets include qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan, the fair value of those insurance policies is deemed to be the present value of the related obligations (subject to any reduction required if the amounts receivable under the insurance policies are not recoverable in full).

Reimbursements

118. **When, and only when, it is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, an entity shall:**

(a) **Recognize its right to reimbursement as a separate asset. The entity shall measure the asset at fair value.**

(b) **Disaggregate and recognize changes in the fair value of its right to reimbursement in the same way as for changes in the fair value of plan assets (see paragraphs 126 and 128). The components of defined benefit cost recognized in accordance with paragraph 122 may be recognized net of amounts relating to changes in the carrying amount of the right to reimbursement.**

119. Sometimes, an entity is able to look to another party, such as an insurer, to pay part or all of the expenditure required to settle a defined benefit obligation. Qualifying insurance policies, as defined in paragraph 8, are plan assets. An entity accounts for qualifying insurance policies in the same way as for all other plan assets, and paragraph 118 is not relevant (see paragraphs 48–51 and 117).

120. When an insurance policy held by an entity is not a qualifying insurance policy, that insurance policy is not a plan asset. Paragraph 118 is relevant to such cases: the entity recognizes its right to reimbursement under the insurance policy as a separate asset, rather than as a deduction in determining the defined benefit deficit or surplus. Paragraph 142(b) requires the entity to disclose a brief description of the link between the reimbursement right and the related obligation.

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

Components of Defined Benefit Cost

122. **An entity shall recognize the components of defined benefit cost, except to the extent that another IPSAS requires or permits their inclusion in the cost of an asset, as follows:**

(a) **Service cost (see paragraphs 68–114 and paragraph 124A) in surplus or deficit;**

(b) **Net interest on the net defined benefit liability (asset) (see paragraphs 125–128) in surplus or deficit; and**

(c) **Remeasurements of the net defined benefit liability (asset) (see paragraphs 129–132) in net assets/equity.**

123. Other IPSASs require the inclusion of some employee benefit costs within the cost of assets, such as inventories and property, plant and equipment (see IPSAS 12 and IPSAS 17). Any post-employment benefit costs included in the cost of such assets include the appropriate proportion of the components listed in paragraph 122.

124. **Remeasurements of the net defined benefit liability (asset) recognized in net assets/equity shall not be reclassified to surplus or deficit in a subsequent period. However, the entity may transfer those amounts recognized in net assets/equity within net assets/equity.**

Current Service Cost

124A. **An entity shall determine current service cost using actuarial assumptions determined at the start of the annual reporting period. However, if an entity remeasures the net defined benefit liability (asset) in accordance with paragraph 101, it shall determine current service cost for the remainder of the annual reporting period after the plan amendment, curtailment or settlement using the actuarial assumptions used to remeasure the net defined benefit liability (asset) in accordance with paragraph 101(b).**

Net Interest on the Net Defined Benefit Liability (Asset)

125. **An entity shall determine net interest on the net defined benefit liability (asset) by multiplying the net defined benefit liability (asset) by the discount rate specified in paragraph 85.**

125A. **To determine net interest in accordance with paragraph 125, an entity shall use the net defined benefit liability (asset) and the discount rate determined at the start of the annual reporting period. However, if an entity remeasures the net defined benefit liability (asset) in accordance with paragraph 101, the entity shall determine net interest for the remainder of the annual reporting period after the plan amendment, curtailment or settlement using:**

(a) **The net defined benefit liability (asset) determined in accordance with paragraph 101(b); and**

(b) **The discount rate used to remeasure the net defined benefit liability (asset) in accordance with paragraph 101(b).**

In applying paragraph 125A, the entity shall also take into account any changes in the net defined benefit liability (asset) during the period resulting from contributions or benefit payments.

126. Net interest on the net defined benefit liability (asset) can be viewed as comprising interest revenue on plan assets, interest cost on the defined benefit obligation and interest on the effect of the asset ceiling mentioned in paragraph 66.

127. Interest revenue on plan assets is a component of the return on plan assets, and is determined by multiplying the fair value of the plan assets by the discount rate specified in paragraph 125A. An entity shall determine the fair value of the plan assets

at the start of the reporting period. However, if an entity remeasures the net defined benefit liability (asset) in accordance with paragraph 101, the entity shall determine interest revenue for the remainder of the annual reporting period after the plan amendment, curtailment or settlement using the plan assets used to remeasure the net defined benefit liability (asset) in accordance with paragraph 101(b). In applying paragraph 127, the entity shall also take into account any changes in the plan assets held during the period resulting from contributions or benefit payments. The difference between the interest revenue on plan assets and the return on plan assets is included in the remeasurement of the net defined benefit liability (asset).

128. Interest on the effect of the asset ceiling is part of the total change in the effect of the asset ceiling, and is determined by multiplying the effect of the asset ceiling by the discount rate specified in paragraph 125A. An entity shall determine the effect of the asset ceiling at the start of the annual reporting period. However, if an entity remeasures the net defined benefit liability (asset) in accordance with paragraph 101, the entity shall determine interest on the effect of the asset ceiling for the remainder of the annual reporting period after the plan amendment, curtailment or settlement taking into account any change in the effect of the asset ceiling determined in accordance with paragraph 103A. The difference between interest on the effect of the asset ceiling and the total change in the effect of the asset ceiling is included in the remeasurement of the net defined benefit liability (asset).

Remeasurements of the Net Defined Benefit Liability (Asset)

129. Remeasurements of the net defined benefit liability (asset) comprise:

(a) Actuarial gains and losses (see paragraphs 130 and 131);

(b) The return on plan assets (see paragraph 132), excluding amounts included in net interest on the net defined benefit liability (asset) (see paragraph 127); and

(c) Any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset) (see paragraph 128).

130. Actuarial gains and losses result from increases or decreases in the present value of the defined benefit obligation because of changes in actuarial assumptions and experience adjustments. Causes of actuarial gains and losses include, for example:

(a) Unexpectedly high or low rates of employee turnover, early retirement or mortality or of increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases) or medical costs;

(b) The effect of changes to assumptions concerning benefit payment options;

(c) The effect of changes in estimates of future employee turnover, early retirement or mortality or of increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases) or medical costs; and

(d) The effect of changes in the discount rate.

131. Actuarial gains and losses do not include changes in the present value of the defined benefit obligation because of the introduction, amendment, curtailment or settlement of the defined benefit plan, or changes to the benefits payable under the defined benefit plan. Such changes result in past service cost or gains or losses on settlement.

132. In determining the return on plan assets, an entity deducts the costs of managing the plan assets and any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the defined benefit obligation (paragraph 78). Other administration costs are not deducted from the return on plan assets.

Presentation

Offset

133. **An entity shall offset an asset relating to one plan against a liability relating to another plan when, and only when, the entity:**

(a) **Has a legally enforceable right to use a surplus in one plan to settle obligations under the other plan; and**

(b) **Intends either to settle the obligations on a net basis, or to realize the surplus in one plan and settle its obligation under the other plan simultaneously.**

134. The offsetting criteria are similar to those established for financial instruments in IPSAS 28, *Financial Instruments: Presentation*.

Current/Non-Current Distinction

135. Some entities distinguish current assets and liabilities from noncurrent assets and liabilities. This Standard does not specify whether an entity should distinguish current and noncurrent portions of assets and liabilities arising from post-employment benefits.

Components of Defined Benefit Cost

136. Paragraph 122 requires an entity to recognize service cost and net interest on the net defined benefit liability (asset) in surplus or deficit. This Standard does not specify how an entity should present service cost and net interest on the net defined benefit liability (asset). An entity presents those components in accordance with IPSAS 1.

Disclosure

137. **An entity shall disclose information that:**

(a) **Explains the characteristics of its defined benefit plans and risks associated with them (see paragraph 141);**

(b) **Identifies and explains the amounts in its financial statements arising from its defined benefit plans (see paragraphs 142–146); and**

(c) **Describes how its defined benefit plans may affect the amount, timing and uncertainty of the entity's future cash flows (see paragraphs 147–149).**

138. To meet the objectives in paragraph 137, an entity shall consider all the following:

(a) The level of detail necessary to satisfy the disclosure requirements;

(b) How much emphasis to place on each of the various requirements;

(c) How much aggregation or disaggregation to undertake; and

(d) Whether users of financial statements need additional information to evaluate the quantitative information disclosed.

139. If the disclosures provided in accordance with the requirements in this Standard and other IPSASs are insufficient to meet the objectives in paragraph 137, an entity shall disclose additional information necessary to meet those objectives. For example, an entity may present an analysis of the present value of the defined benefit obligation that distinguishes the nature, characteristics and risks of the obligation. Such a disclosure could distinguish:

(a) Between amounts owing to active members, deferred members, and pensioners.

(b) Between vested benefits and accrued but not vested benefits.

(c) Between conditional benefits, amounts attributable to future salary increases and other benefits.

140. An entity shall assess whether all or some disclosures should be disaggregated to distinguish plans or groups of plans with materially different risks. For example, an entity may disaggregate disclosure about plans showing one or more of the following features:

(a) Different geographical locations.

(b) Different characteristics such as flat salary pension plans, final salary pension plans or post-employment medical plans.

(c) Different regulatory environments.

(d) Different reporting segments.

(e) Different funding arrangements (e.g., wholly unfunded, wholly or partly funded).

Characteristics of Defined Benefit Plans and Risks Associated with Them

141. An entity shall disclose:

(a) Information about the characteristics of its defined benefit plans, including:

(i) The nature of the benefits provided by the plan (e.g., final salary defined benefit plan or contribution-based plan with guarantee).

(ii) A description of the regulatory framework in which the plan operates, for example the level of any minimum funding requirements, and any effect of the regulatory framework on the plan, such as the asset ceiling (see paragraph 66).

(iii) A description of any other entity's responsibilities for the governance of the plan, for example responsibilities of trustees or of management of the plan.

(b) A description of the risks to which the plan exposes the entity, focused on any unusual, entity-specific or plan-specific risks, and of any significant concentrations of risk. For example, if plan assets are invested primarily in one class of investments, e.g., property, the plan may expose the entity to a concentration of property market risk.

(c) A description of any plan amendments, curtailments and settlements.

(d) The basis on which the discount rate has been determined.

Explanation of Amounts in the Financial Statements

142. An entity shall provide a reconciliation from the opening balance to the closing balance for each of the following, if applicable:

(a) The net defined benefit liability (asset), showing separate reconciliations for:

(i) Plan assets.

(ii) The present value of the defined benefit obligation.

(iii) The effect of the asset ceiling.

(b) Any reimbursement rights. An entity shall also describe the relationship between any reimbursement right and the related obligation.

143. Each reconciliation listed in paragraph 142 shall show each of the following, if applicable:

(a) Current service cost.

(b) Interest revenue or expense.

(c) Remeasurements of the net defined benefit liability (asset), showing separately:

(i) The return on plan assets, excluding amounts included in interest in (b).

(ii) Actuarial gains and losses arising from changes in demographic assumptions (see paragraph 78(a)).

(iii) Actuarial gains and losses arising from changes in financial assumptions (see paragraph 78(b)).

(iv) Changes in the effect of limiting a net defined benefit asset to the asset ceiling, excluding amounts included in interest in (b). An entity shall also disclose how it determined the maximum economic benefit available, i.e., whether those benefits would be in the form of refunds, reductions in future contributions or a combination of both.

(d) Past service cost and gains and losses arising from settlements. As permitted by paragraph 102, past service cost and gains and losses arising from settlements need not be distinguished if they occur together.

(e) The effect of changes in foreign exchange rates.

(f) Contributions to the plan, showing separately those by the employer and by plan participants.

(g) Payments from the plan, showing separately the amount paid in respect of any settlements.

(h) The effects of public sector combinations and disposals.

144. An entity shall disaggregate the fair value of the plan assets into classes that distinguish the nature and risks of those assets, subdividing each class of plan asset into those that have a quoted market price in an active market and those that do not. For example, and considering the level of disclosure discussed in paragraph 138, an entity could distinguish between:

(a) Cash and cash equivalents;

(b) Equity instruments (segregated by industry type, company size, geography etc.);

(c) Debt instruments (segregated by type of issuer, credit quality, geography etc.);

(d) Real estate (segregated by geography etc.);

(e) Derivatives (segregated by type of underlying risk in the contract, for example, interest rate contracts, foreign exchange contracts, equity contracts, credit contracts, longevity swaps etc.);

(f) Investment funds (segregated by type of fund);

(g) Asset-backed securities; and

(h) Structured debt.

145. An entity shall disclose the fair value of the entity's own transferable financial instruments held as plan assets, and the fair value of plan assets that are property occupied by, or other assets used by, the entity.

146. An entity shall disclose the significant actuarial assumptions used to determine the present value of the defined benefit obligation (see paragraph 78). Such disclosure shall be in absolute terms (e.g., as an absolute percentage, and not just as a margin between different percentages and other variables). When an entity provides disclosures in total for a grouping of plans, it shall provide such disclosures in the form of weighted averages or relatively narrow ranges.

Amount, Timing and Uncertainty of Future Cash Flows

147. An entity shall disclose:

(a) A sensitivity analysis for each significant actuarial assumption (as disclosed under paragraph 146) as of the end of the reporting period, showing how the defined benefit obligation would have been affected by changes in the relevant actuarial assumption that were reasonably possible at that date.

(b) The methods and assumptions used in preparing the sensitivity analyses required by (a) and the limitations of those methods.

(c) Changes from the previous period in the methods and assumptions used in preparing the sensitivity analyses, and the reasons for such changes.

148. An entity shall disclose a description of any asset-liability matching strategies used by the plan or the entity, including the use of annuities and other techniques, such as longevity swaps, to manage risk.

149. To provide an indication of the effect of the defined benefit plan on the entity's future cash flows, an entity shall disclose:

(a) A description of any funding arrangements and funding policy that affect future contributions.

(b) The expected contributions to the plan for the next reporting period.

(c) Information about the maturity profile of the defined benefit obligation. This will include the weighted average duration of the defined benefit obligation and may include other information about the distribution of the timing of benefit payments, such as a maturity analysis of the benefit payments.

Multi-Employer Plans

150. If an entity participates in a multi-employer defined benefit plan, it shall disclose:

(a) A description of the funding arrangements, including the method used to determine the entity's rate of contributions and any minimum funding requirements.

(b) A description of the extent to which the entity can be liable to the plan for other entities' obligations under the terms and conditions of the multi-employer plan.

(c) A description of any agreed allocation of a deficit or surplus on:

(i) Wind-up of the plan; or

(ii) The entity's withdrawal from the plan.

(d) If the entity accounts for that plan as if it were a defined contribution plan in accordance with paragraph 34, it shall disclose the following, in addition to the information required by (a)–(c) and instead of the information required by paragraphs 141–149:

(i) The fact that the plan is a defined benefit plan.

(ii) The reason why sufficient information is not available to enable the entity to account for the plan as a defined benefit plan.

(iii) The expected contributions to the plan for the next reporting period.

(iv) Information about any deficit or surplus in the plan that may affect the amount of future contributions, including the basis used to determine that deficit or surplus and the implications, if any, for the entity.

(v) An indication of the level of participation of the entity in the plan compared with other participating entities. Examples of measures that might provide such an indication include the entity's proportion of the total contributions to the plan or the entity's proportion of the total number of active members, retired members, and former members entitled to benefits, if that information is available.

Defined Benefit Plans that Share Risks Between Entities under Common Control

151. If an entity participates in a defined benefit plan that shares risks between entities under common control, it shall disclose:

(a) The contractual agreement or stated policy for charging the net defined benefit cost or the fact that there is no such policy.

(b) The policy for determining the contribution to be paid by the entity.

(c) If the entity accounts for an allocation of the net defined benefit cost as noted in paragraph 41, all the information about the plan as a whole required by paragraphs 137–149.

(d) If the entity accounts for the contribution payable for the period as noted in paragraph 41, the information about the plan as a whole required by paragraphs 137–139, 141, 144–146 and 149(a) and (b).

152. The information required by paragraph 151(c) and (d) can be disclosed by cross-reference to disclosures in another group entity's financial statements if:

(a) That group entity's financial statements separately identify and disclose the information required about the plan; and

(b) That group entity's financial statements are available to users of the financial statements on the same terms as the financial statements of the entity and at the same time as, or earlier than, the financial statements of the entity.

Disclosure Requirements in Other IPSASs

153. Where required by IPSAS 20, an entity discloses information about:

(a) Related party transactions with post-employment benefit plans; and

(b) Post-employment benefits for key management personnel.

154. Where required by IPSAS 19, an entity discloses information about contingent liabilities arising from post-employment benefit obligations.

Other Long-Term Employee Benefits

155. Other long-term employee benefits include items such as the following, if not expected to be settled wholly before twelve months after the end of the reporting period in which the employees render the related service:

(a) Long-term paid absences such as long service or sabbatical leave;

(b) Jubilee or other long service benefits;

(c) Long-term disability benefits;

(d) Profit sharing and bonuses;

(e) Deferred remuneration; and

(f) Compensation payable by the entity until an individual enters new employment.

156. The measurement of other long-term employee benefits is not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. For this reason, this Standard requires a simplified method of accounting for other long-term employee benefits. Unlike the accounting required for post-employment benefits, this method does not recognize remeasurements in net assets/equity.

157. This Standard includes a rebuttable presumption that long-term disability payments are not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. Where this presumption is rebutted, the entity considers whether some or all long-term disability payments should be accounted for in accordance with paragraphs 57–154.

Recognition and Measurement

158. **In recognizing and measuring the surplus or deficit in another long-term employee benefit plan, an entity shall apply paragraphs 58–100 and 115–117. An entity shall apply paragraphs 118–121 in recognizing and measuring any reimbursement right.**

159. **For other long-term employee benefits, an entity shall recognize the net total of the following amounts in surplus or deficit, except to the extent that another IPSAS requires or permits their inclusion in the cost of an asset:**

(a) **Service cost (see paragraphs 68–114 and paragraph 124A);**

(b) **Net interest on the net defined benefit liability (asset) (see paragraphs 125-128); and**

(c) **Remeasurements of the net defined benefit liability (asset) (see paragraphs 129–132).**

160. One form of other long-term employee benefit is long-term disability benefit. If the level of benefit depends on the length of service, an obligation arises when the service is rendered. Measurement of that obligation reflects the probability that payment will be required, and the length of time for which payment is expected to be made. If the level of benefit is the same for any disabled employee regardless of years of service, the expected cost of those benefits is recognized when an event occurs that causes a long-term disability.

Disclosure

161. Although this Standard does not require specific disclosures about other long-term employee benefits, other IPSASs may require disclosures. For example, IPSAS 20 requires disclosures about employee benefits for key management personnel. IPSAS 1 requires disclosure of employee benefits expense.

Termination Benefits

162. This Standard deals with termination benefits separately from other employee benefits, because the event that gives rise to an obligation is the termination of employment rather than employee service. Termination benefits result from either an entity's decision to terminate the employment or an employee's decision to accept an entity's offer of benefits in exchange for termination of employment.

163. Termination benefits do not include employee benefits resulting from termination of employment at the request of the employee without an entity's offer, or as a result of mandatory retirement requirements, because those benefits are post-employment benefits. Some entities provide a lower level of benefit for termination of employment at the request of the employee (in substance, a post-employment benefit) than for termination of employment at the request of the entity. The difference between the benefit provided for termination of employment at the request of the employee and a higher benefit provided at the request of the entity is a termination benefit.

164. The form of the employee benefit does not determine whether it is in exchange provided for service or in exchange for termination of the employee's employment. Termination benefits are typically lump sum payments, but sometimes also include:

(a) Enhancement of post-employment benefits, either indirectly through an employee benefit plan or directly.

(b) Salary until the end of a specified notice period if the employee renders no further service that provides economic benefits to the entity.

165. Indicators that an employee benefit is provided in exchange for services include the following:

(a) The benefit is conditional on future service being provided (including benefits that increase if further service is provided).

(b) The benefit is provided in accordance with the terms of an employee benefit plan.

166. Some termination benefits are provided in accordance with the terms of an existing employee benefit plan. For example, they may be specified by statute, employment contract or union agreement, or may be implied as a result of the employer's past practice of providing similar benefits. As another example, if an entity makes an offer of benefits available for more than a short period, or there is more than a short period between the offer and the expected date of actual termination, the entity considers whether it has established a new employee benefit plan and hence whether the benefits offered under that plan are

termination benefits or post-employment benefits. Employee benefits provided in accordance with the terms of an employee benefit plan are termination benefits if they both result from an entity's decision to terminate an employee's employment and are not conditional on future service being provided.

167. Some employee benefits are provided regardless of the reason for the employee's departure. The payment of such benefits is certain (subject to any vesting or minimum service requirements) but the timing of their payment is uncertain. Although such benefits are described in some jurisdictions as termination indemnities or termination gratuities, they are post-employment benefits rather than termination benefits, and an entity accounts for them as post-employment benefits.

Recognition

168. **An entity shall recognize a liability and expense for termination benefits at the earlier of the following dates:**

(a) **When the entity can no longer withdraw the offer of those benefits; and**

(b) **When the entity recognizes costs for a restructuring that is within the scope of IPSAS 19 and involves the payment of termination benefits.**

169. For termination benefits payable as a result of an employee's decision to accept an offer of benefits in exchange for the termination of employment, the time when an entity can no longer withdraw the offer of termination benefits is the earlier of:

(a) When the employee accepts the offer; and

(b) When a restriction (e.g., a legal, regulatory or contractual requirement or other restriction) on the entity's ability to withdraw the offer takes effect. This would be when the offer is made, if the restriction existed at the time of the offer.

170. For termination benefits payable as a result of an entity's decision to terminate an employee's employment, the entity can no longer withdraw the offer when the entity has communicated to the affected employees a plan of termination meeting all of the following criteria:

(a) Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made.

(b) The plan identifies the number of employees whose employment is to be terminated, their job classifications or functions and their locations (but the plan need not identify each individual employee) and the expected completion date.

(c) The plan establishes the termination benefits that employees will receive in sufficient detail that employees can determine the type and amount of benefits they will receive when their employment is terminated.

171. When an entity recognizes termination benefits, the entity may also have to account for a plan amendment or a curtailment of other employee benefits (see paragraph 105).

Measurement

172. **An entity shall measure termination benefits on initial recognition, and shall measure and recognize subsequent changes, in accordance with the nature of the employee benefit, provided that if the termination benefits are an enhancement to post-employment benefits, the entity shall apply the requirements for post-employment benefits. Otherwise:**

(a) **If the termination benefits are expected to be settled wholly before twelve months after the end of the reporting period in which the termination benefit is recognized, the entity shall apply the requirements for short-term employee benefits.**

(b) **If the termination benefits are not expected to be settled wholly before twelve months after the end of the reporting period, the entity shall apply the requirements for other long-term employee benefits.**

173. Because termination benefits are not provided in exchange for service, paragraphs 72–76 relating to the attribution of the benefit to periods of service are not relevant.

Disclosure

174. Although this Standard does not require specific disclosures about termination benefits, other IPSASs may require disclosures. For example, IPSAS 20 requires disclosures about employee benefits for key management personnel. IPSAS 1 requires disclosure of employee benefits expense.

Transitional Provisions

175. **An entity shall apply this Standard retrospectively, in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, except that:**

   (a) **An entity need not adjust the carrying amount of assets outside the scope of this Standard for changes in employee benefit costs that were included in the carrying amount before the date of initial application. The date of initial application is the beginning of the earliest prior period presented in the first financial statements in which the entity adopts this Standard.**

   (b) **In financial statements for periods beginning before January 1, 2018, an entity need not present comparative information for the disclosures required by paragraph 147 about the sensitivity of the defined benefit obligation.**

Effective Date

176. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2018, it shall disclose that fact.**

176A. **Paragraphs 59, 101, 122, 125, 127, 128 and 159 were amended, and paragraphs 103A, 124A and 125A added by *Improvements to IPSAS, 2018*, issued in October 2018. An entity shall apply these amendments to plan amendments, curtailments or settlements occurring on or after the beginning of the first annual reporting period that begins on or after January 1, 2019. Earlier application is permitted. If an entity applies these amendments earlier, it shall disclose that fact.**

176B. **Paragraphs 3 and 4 were amended by *Improvements to IPSAS, 2021*, issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is permitted.**

177. When an entity adopts the accrual basis IPSASs of accounting as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

Withdrawal and Replacement of IPSAS 25 (2008)

178. This Standard supersedes IPSAS 25, *Employee Benefits* (2008). IPSAS 25 remains applicable until IPSAS 39 is applied or becomes effective, whichever is earlier.

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 39.

Example Illustrating Paragraph 19: Accounting for Performance-Related Bonus Plan

AG1. A performance-related bonus plan requires a government printing unit to pay a specified proportion of its surplus for the year to employees who meet predetermined performance targets and serve throughout the year, i.e., are in post on both the first and last day of the reporting period. If no employees leave during the year, the total bonus payments for the year will be 3% of actual surplus. The entity determines that staff turnover will reduce the payments to 2.5% of actual surplus.

The entity recognizes a liability and an expense of 2.5% of actual surplus.

Example Illustrating Paragraph 37: Accounting for a Multi-Employer Plan

AG2. Along with similar entities in State X, Local Government Unit A participates in a multi-employer defined benefit plan. Because the plan exposes the participating entities to actuarial risks associated with the current and former employees of other local government units participating in the plan, there is no consistent and reliable basis for allocating the obligation, plan assets, and cost to individual local government units participating in the plan. Local Government Unit A therefore accounts for the plan as if it were a defined contribution plan. A funding valuation, which is not drawn up on the basis of assumptions compatible with the requirements of this Standard, shows a deficit of CU480 million[a] in the plan. The plan has agreed, under a binding arrangement, a schedule of contributions with the participating employers in the plan that will eliminate the deficit over the next five years. Local Government Unit A's total contributions under the contract are CU40 million.

The entity recognizes a liability for the contributions adjusted for the time value of money and an equal expense in surplus or deficit.

(a) In this Standard monetary amounts are denominated in "currency units (CU)".

Example Illustrating Paragraph 70: Projected Unit Credit Method

AG3. A lump sum benefit is payable on termination of service and equal to 1% of final salary for each year of service. The salary in year 1 is CU10,000 and is assumed to increase at 7% (compound) each year. The discount rate used is 10% per annum. The following table shows how the obligation builds up for an employee who is expected to leave at the end of year five, assuming that there are no changes in actuarial assumptions. For simplicity, this example ignores the additional adjustment needed to reflect the probability that the employee may leave the entity at an earlier or later date.

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

Note:

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

Examples Illustrating Paragraph 73: Attributing Benefit to Years of Service

AG4. A defined benefit plan provides a lump sum benefit of CU100 payable on retirement for each year of service.

A benefit of CU100 is attributed to each year. The current service cost is the present value of CU100. The present value of the defined benefit obligation is the present value of CU100, multiplied by the number of years of service up to the end of the reporting period.

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

AG5. A plan provides a monthly pension of 0.2% of final salary for each year of service. The pension is payable from the age of 65.

Benefit equal to the present value, at the expected retirement date, of a monthly pension of 0.2% of the estimated final salary payable from the expected retirement date until the expected date of death is attributed to each year of service. The current service cost is the present value of that benefit. The present value of the defined benefit obligation is the present value of monthly pension payments of 0.2% of final salary, multiplied by the number of years of service up to the end of the reporting period. The current service cost and the present value of the defined benefit obligation are discounted, because pension payments begin at the age of 65.

Examples Illustrating Paragraph 74: Vesting and Non-Vesting Benefits

AG6. A plan pays a benefit of CU100 for each year of service. The benefits vest after 10 years of service.

A benefit of CU100 is attributed to each year. In each of the first 10 years, the current service cost and the present value of the obligation reflect the probability that the employee may not complete 10 years of service.

AG7. A plan pays a benefit of CU100 for each year of service, excluding service before the age of 25. The benefits vest immediately.

No benefit is attributed to service before the age of 25 because service before that date does not lead to benefits (conditional or unconditional). A benefit of CU100 is attributed to each subsequent year.

Examples Illustrating Paragraph 75: Attributing Benefits to Accounting Periods

AG8. A plan pays a lump sum benefit of CU1,000 that vests after 10 years of service. The plan provides no further benefit for subsequent service.

A benefit of CU100 (CU1,000 divided by 10) is attributed to each of the first 10 years. The current service cost in each of the first 10 years reflects the probability that the employee may not complete 10 years of service. No benefit is attributed to subsequent years.

AG9. A plan pays a lump sum retirement benefit of CU2,000 to all employees who are still employed at the age of 55 after 20 years of service, or who are still employed at the age of 65, regardless of their length of service.

For employees who join before the age of 35, service first leads to benefits under the plan at the age of 35 (an employee could leave at the age of 30 and return at the age of 33, with no effect on the amount or timing of benefits). Those benefits are conditional on further service. Also, service beyond the age of 55 will lead to no material amount of further benefits. For these employees, the entity attributes benefit of CU100 (CU2,000 divided by 20) to each year from the age of 35 to the age of 55.

For employees who join between the ages of 35 and 45, service beyond twenty years will lead to no material amount of further benefits. For these employees, the entity attributes benefit of 100 (CU2,000 divided by 20) to each of the first 20 years.

For an employee who joins at the age of 55, service beyond 10 years will lead to no material amount of further benefits. For this employee, the entity attributes benefit of CU200 (CU2,000 divided by 10) to each of the first 10 years.

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

AG10. A post-employment medical plan reimburses 40% of an employee's post-employment medical costs if the employee leaves after more than 10 and less than 20 years of service, and 50% of those costs if the employee leaves after 20 or more years of service.

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

AG11. A post-employment medical plan reimburses 10% of an employee's post-employment medical costs if the employee leaves after more than 10 and less than 20 years of service, and 50% of those costs if the employee leaves after 20 or more years of service.

Service in later years will lead to a materially higher level of benefit than in earlier years. Therefore, for employees expected to leave after 20 or more years, the entity attributes benefit on a straight-line basis under paragraph 73. Service beyond 20 years will lead to no material amount of further benefits. Therefore, the benefit attributed to each of the first 20 years is 2.5% of the present value of the expected medical costs (50% divided by 20).

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

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

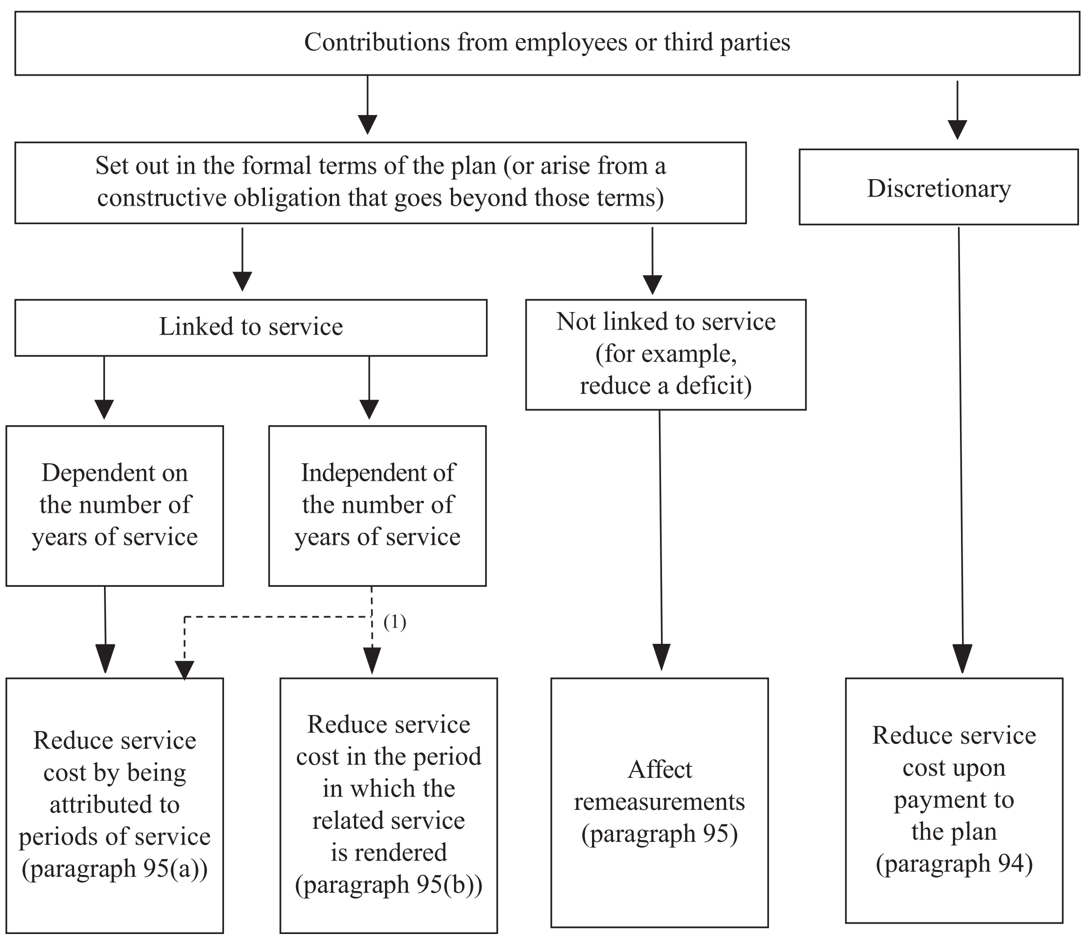
Example Illustrating Paragraph 76: Attributing Benefits to Accounting Periods

AG12. Employees are entitled to a benefit of 3% of final salary for each year of service before the age of 55.

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

Example Illustrating Paragraphs 94 and 95: Contributions from employees or third parties

AG13. The accounting requirements for contributions from employees or third parties are illustrated in the diagram below.



(1) This dotted arrow means that an entity is permitted to choose either accounting

Example Illustrating Paragraphs 162-173: Termination Benefits

AG14. Background

As a result of a recent acquisition, an entity plans to close a factory in 10 months and, at that time, terminate the employment of all of the remaining employees at the factory. Because the entity needs the expertise of the employees at the factory to complete some contracts, it announces a plan of termination as follows.

Each employee who stays and renders service until the closure of the factory will receive on the termination date a cash payment of CU30,000. Employees leaving before closure of the factory will receive CU10,000.

There are 120 employees at the factory. At the time of announcing the plan, the entity expects 20 of them to leave before closure. Therefore, the total expected cash outflows under the plan are CU3,200,000 (i.e., 20 × CU10,000 + 100 × CU30,000). As required by paragraph 163, the entity accounts for benefits provided for termination of employment as termination benefits and accounts for benefits provided for services as short-term employee benefits.

Termination benefits

The benefit provided for termination of employment is CU10,000. This is the amount that an entity would have to pay for terminating the employment regardless of whether the employees stay and render service until closure of the factory or they leave before closure. Even though the employees can leave before closure, the termination of all employees' employment is a result of the entity's decision to close the factory and terminate their employment (i.e., all employees will leave employment when the factory closes). Therefore the entity recognizes a liability of CU1,200,000 (i.e., 120 × CU10,000) for the termination benefits provided in accordance with the employee benefit plan at the earlier of when the plan of termination is announced and when the entity recognizes the restructuring costs associated with the closure of the factory.

Benefits provided for service

The incremental benefits that employees will receive if they provide services for the full ten-month period are for services provided over that period. The entity accounts for them as short-term employee benefits because the entity expects to settle them before twelve months after the end of the reporting period. In this example, discounting is not required, so an expense of CU200,000 (i.e., CU2,000,000 ÷ 10) is recognized in each month during the service period of 10 months, with a corresponding increase in the carrying amount of the liability.

Appendix B

Amendments to Other IPSASs

[Deleted]

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 39.

Objective

BC1. IPSAS 25 (2008), *Employee Benefits*, was drawn primarily from International Accounting Standard (IAS) 19 (2004), *Employee Benefits*, International Accounting Standard (IASB). The IASB made a number of amendments to IAS 19 in the 2011-2015 period.

BC2. In order to update IPSAS 25, the IPSASB approved a limited scope review of IPSAS 25 to converge with the revised IAS 19. The IPSASB decided not to reopen the public sector specific requirements in IPSAS 25, except for the section on Composite Social Security Programs (see paragraphs BC5 and BC6 below).

BC3. In January 2016, the IPSASB issued Exposure Draft (ED) 59, *Amendments to IPSAS 25, Employee Benefits.* ED 59 proposed amendments to maintain convergence with IAS 19. The proposed amendments made a large number of changes to the text of IPSAS 25. A number of respondents expressed reservations that the scale of these changes impaired the understandability of IPSAS 25. The IPSASB therefore decided to issue a new IPSAS 39, *Employee Benefits*, rather than a revised IPSAS 25, in order to help preparers.

BC4. This Basis for Conclusions summarizes the IPSASB's considerations in reaching the conclusions in IPSAS 39, *Employee Benefits*. With the exception of Composite Social Security Programs, the Basis for Conclusions only considers those areas where IPSAS 39 departs from the main requirements of IAS 19 (amended in 2011 onwards), or where the IPSASB considered such departures.

Composite Social Security Programs

BC5. ED 59 indicated that the IPSASB was considering the deletion of the section on Composite Social Security Programs, because the IPSASB was not aware that it had been applied in any jurisdiction. The IPSASB specifically asked for comments on this issue.

BC6. No respondent to ED 59 identified a jurisdiction where entities applied these requirements. The majority of respondents supported the deletion of the section on Composite Social Security Programs. As the IPSASB did not identify a new and compelling reason to retain the section, the IPSASB decided not to include it in IPSAS 39.

State Plans

BC7. This Standard retains the requirement in IAS 19 that an entity accounts for a state plan in the same way as for a multi-employer plan. The IPSASB concluded that it should provide further commentary to clarify the approach to accounting for state plans by public sector entities as in IPSAS 25. Paragraph 47 provides a rebuttable presumption that the state plan will be characterized as a defined benefit plan by the controlling entity. Only where that presumption is rebutted is the state plan accounted for as a defined contribution plan.

Defined Benefit Plans with Participating Entities under Common Control

BC8. In the public sector, there are likely to be many cases where entities under common control participate in defined benefit plans. IAS 19 includes commentary on defined benefit plans that share risks between entities under common control. The IPSASB considered that the requirements in IAS 19 are appropriate in the public sector. The IPSASB also considered it appropriate to emphasize that, unless there is a contractual agreement, binding arrangement, or stated policy for charging the net defined benefit cost for the plan as a whole to an individual entity, it is inappropriate for controlled entities to account on a defined benefit basis as in IPSAS 25. In such cases, the controlling entity should account for such plans on a defined benefit basis in its consolidated financial statements. Controlled entities (a) account on a defined contribution basis, (b) identify the controlling entity, and (c) disclose that the controlling entity is accounting on a defined benefit basis in its consolidated financial statements. This is reflected in paragraph 42. Controlled entities also make the disclosures specified in paragraph 151.

Discount Rates

BC9. IAS 19 requires adoption of a discount rate based on the market yields at the end of the reporting period on high quality corporate bonds. The IPSASB decided that the discount rate should reflect the time value of money, and considered that entities should be left to determine the rate that best achieves that objective in the same way as in IPSAS 25. The IPSASB considered that the time value of money may be best reflected by reference to market yields on government bonds, high quality corporate bonds, or any other financial instrument. The discount rate used is not intended to incorporate the risk associated with defined benefit obligations or entity-specific credit risk. There is an additional disclosure requirement at paragraph 141(d) informing users of the basis on which the discount rate has been determined.

BC10. The IPSASB considered whether it should provide guidance to assist entities operating in jurisdictions where there is neither a deep market in government bonds nor a deep market in high quality corporate bonds to determine a discount rate that reflects the time value of money. The IPSASB acknowledges that determination of an appropriate discount rate is likely to be a difficult issue for entities operating in such jurisdictions, and that such entities may be in the process of migrating, or have recently migrated, to the accrual basis of accounting. However, the IPSASB concluded that this is not an issue that applies only in the public sector, and that there is an insufficiently clear public sector-specific reason to provide such guidance.

Other Long-Term Employee Benefits: Long-Term Disability Benefits

BC11. IAS 19 lists long-term disability benefits as an example of an "other long-term employee benefit." IAS 19 states that "the measurement of other long-term employee benefits is not usually subject to the same degree of uncertainty as the measurement of post-employment benefits." In the public sector, disability benefits related to certain areas of service provision, such as the military, may be financially highly significant, and related actuarial gains or losses volatile.

BC12. Therefore, IPSAS 39 retains the rebuttable presumption included in IPSAS 25 that long-term disability payments are not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. Where this presumption is rebutted, the entity considers whether some or all long-term disability payments should be accounted for using the same requirements as for post-employment benefits.

Other Long-Term Employee Benefits: Compensation Payable by the Reporting Entity until an Individual Enters New Employment

BC13. Although it does not consider it likely that such circumstances are widespread, the IPSASB acknowledged that there may be cases where a reporting entity is contractually bound to make compensation payments separate from a termination benefit to a past employee until he/she enters new employment. The list of other long-term benefits in paragraph 155 was therefore amended to include such circumstances, as in IPSAS 25.

Remeasurements

BC14. IAS 19 (amended in 2011) recognizes remeasurements of the net defined liability (asset) in other comprehensive income rather than in profit or loss. The IPSASB noted that *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* does not acknowledge "other comprehensive income", and that "other comprehensive income" is not a defined term in IPSAS 1, *Presentation of Financial Statements*. The IPSASB considered that recognizing remeasurements in net assets/equity would have the same accounting outcome as IAS 19 in not impacting surplus or deficit with components of defined benefit cost that have different predictive values. Therefore, the IPSASB decided to recognize remeasurements in net assets/equity rather than surplus or deficit.

BC15. The IPSASB noted that paragraph 45 of IPSAS 1 requires an entity to present each material class of similar items separately in the financial statements. Items of a dissimilar nature or function are presented separately, unless they are immaterial. Therefore, the IPSASB considered that a separate presentation of remeasurements of post-employment benefits may be required in the statement of changes in net assets/equity, if it is material.

Requirements of Government Finance Statistics Reporting Guidelines

BC16. The IPSASB considered the requirements of Government Finance Statistics (GFS) reporting guidelines on the classification, presentation, recognition, measurement and disclosure of employee benefits and identified some differences with both the revised IAS 19 and with IPSAS 39.

BC17. GFS reporting guidelines do not apply the net interest approach, but rather recognize the proceeds of fund assets and interest on fund liabilities according to the economic nature of these revenues and expenses. GFS then attributes the property income and the increase in the liability for benefit entitlements due to the passage of time through an entry in "property expense for investment income disbursements". In IPSAS 39 equivalent entries are presented in surplus or deficit.

BC18. For autonomous funds recognized outside the employer's accounts, GFS recognizes a claim of the pension fund on the pension manager for deficits of the pension fund in specific circumstances. In these cases, GFS does not require the recognition of an interest expense in the employers' accounts due to the passage of time in recognizing that claim.

BC19. In GFS, the plan assets are generally measured on the same basis as other assets, which is normally market value. Therefore, unlike IPSAS 39, no additional calculation to include the discount rate in the plan assets as a whole is necessary to estimate present value. However, in GFS some assets are not measured at market value. This may give rise to different valuations between IPSAS 39 and GFS (for example: loans are measured at nominal value in GFS and usually at amortized cost in IPSAS).

BC20. In GFS, any changes in the volume or value of assets that do not result from transactions are recorded in the Statement of Other Economic Flows, which includes the effect of the passage of time. In GFS, the pension fund only records actual revenue from transactions such as interest, dividends and rents in the Statement of Operations.

BC21. GFS does not disaggregate employee benefits into short-term and long-term employee benefits and does not require specific disclosures on employee benefits, except for the supplementary table on pension schemes in social insurance specified in the System of National Accounts 2008.

BC22. The IPSASB concluded that these differences are due to the different objectives and presentational frameworks of IPSAS and GFS. They do not constitute public sector specific reasons that warrant departure from IAS 19.

Revision of IPSAS 39 as a result of *Improvements to IPSAS, 2018*

BC23. The IPSASB reviewed the revisions to IAS 19, *Employee Benefits*, included in *Plan Amendment, Curtailment or Settlement* (Amendments to IAS 19) issued by the IASB in February 2018, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions. The IPSASB generally concurred that there was no public sector specific reason for not adopting the amendments.

Revision of IPSAS 39 as a result of *Improvements to IPSAS, 2021*

BC24. Stakeholders noted that the word "composite" could be deleted from the term "composite social security programs" because the IPSAS defined term "composite social security programs" and related requirements were not included in the final version of IPSAS 39 (see paragraphs BC5-BC6). The IPSASB agreed with this view and decided to amend paragraphs 3 and 4 of IPSAS 39 in *Improvements to IPSAS, 2021*.

Comparison with IAS 19

IPSAS 39 is drawn primarily from IAS 19 (issued in 2011, including amendments up to December 31, 2018). The main differences between IPSAS 39 and IAS 19 are as follows:

- IPSAS 39 contains additional guidance on public sector bonus plans.
- For discounting post-employment obligations, IAS 19 requires entities to apply a discount rate based on yields on high quality corporate bonds consistent with the currency and estimated term of the post-employment benefit obligations. The requirement in IPSAS 39 is that entities apply a rate that reflects the time value of money. IPSAS 39 also contains a requirement that entities disclose the basis on which the discount rate has been determined.
- IPSAS 39 includes a rebuttable presumption that long-term disability payments are not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. Where this presumption is rebutted, the entity considers whether some or all long-term disability payments should be accounted for in the same way as for post-employment benefits. IAS 19 does not include such a rebuttable presumption.
- IPSAS 39 recognizes remeasurements of the net defined benefit liability (asset) in net assets/equity. IAS 19 recognizes them in other comprehensive income.
- IPSAS 39 uses different terminology, in certain instances, from IAS 19. The most significant examples are the use of the terms “revenue”, “controlling” and “controlled entities”. The equivalent terms in IAS 19 are “income”, “parent” and “subsidiaries”.

IPSAS 40—PUBLIC SECTOR COMBINATIONS

Acknowledgment

The acquisition accounting requirements of this International Public Sector Accounting Standard (IPSAS) draw upon International Financial Reporting Standard (IFRS) 3, *Business Combinations,* published by the International Accounting Standards Board (IASB). Extracts from IFRS 3 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards Foundation.

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IPSAS 40—PUBLIC SECTOR COMBINATIONS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 40, *Public Sector Combinations* was issued in January 2017.

Since then, IPSAS 40 has been amended by the following IPSASs:

- IPSAS 43, *Leases* (issued January 2022)
- *COVID-19: Deferral of Effective Dates* (issued November 2020)
- *Improvements to IPSAS 2019* (issued January 2020)
- *Improvements to IPSAS 2018* (issued October 2018)
- IPSAS 41, *Financial Instruments* (issued August 2018)

Table of Amended Paragraphs in IPSAS 40

Paragraph Affected	How Affected	Affected By
25	Amended	IPSAS 41 August 2018
45	Amended	IPSAS 41 August 2018
68	Amended	IPSAS 43 January 2022
70	Amended	IPSAS 41 August 2018
71	Amended	IPSAS 43 January 2022
Heading above paragraph 82A	New	IPSAS 43 January 2022
82A	New	IPSAS 43 January 2022
82B	New	IPSAS 43 January 2022
100A	New	Improvements to IPSAS October 2018
111	Amended	IPSAS 41 August 2018
115	Amended	IPSAS 41 August 2018
117	Amended	IPSAS 41 August 2018
120	Amended	IPSAS 43 January 2022
126A	Amended	COVID-19: Deferral of Effective Dates November 2020
126B	New	Improvements to IPSAS October 2018
126C	New	Improvements to IPSAS January 2020
126D	New	Improvements to IPSAS January 2020
126E	New	IPSAS 43 January 2022
Heading above paragraph AG72	Deleted	IPSAS 43 January 2022
AG72	Deleted	IPSAS 43 January 2022
AG73	Deleted	IPSAS 43 January 2022
AG74	Deleted	IPSAS 43 January 2022
AG76	Amended	IPSAS 43 January 2022
AG88	Amended	IPSAS 41 August 2018
AG89	Amended	IPSAS 43 January 2022
IE224	Amended	IPSAS 43 January 2022

IPSAS 40—PUBLIC SECTOR COMBINATIONS

CONTENTS

International Public Sector Accounting Standard 40, *Public Sector Combinations*, is set out in paragraphs 1–62. All the paragraphs have equal authority. IPSAS 40 should be read in the context of its objective, the Basis for Conclusions, the Preface to *International Public Sector Accounting Standards, and the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to improve the relevance, faithful representativeness and comparability of the information that a reporting entity provides in its financial statements about a public sector combination and its effects. To accomplish that, this Standard establishes principles and requirements for how:

   (a) A reporting entity classifies a public sector combination as an amalgamation or an acquisition;

   (b) A resulting entity recognizes and measures in its financial statements the identifiable assets received, the liabilities assumed and any non-controlling interest in an amalgamation;

   (c) A resulting entity recognizes and measures components of net assets/equity and other adjustments recognized in an amalgamation;

   (d) An acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired operation;

   (e) An acquirer recognizes and measures the goodwill acquired in, or the gain or loss arising from, an acquisition; and

   (f) A reporting entity determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of a public sector combination.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for public sector combinations.**

3. **This Standard applies to a transaction or other event that meets the definition of a public sector combination. This Standard does not apply to:**

   (a) **The accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself.**

   (b) **The acquisition or receipt of an asset or a group of assets (and any related liabilities) that does not constitute an operation. In such cases an entity shall identify and recognize the individual identifiable assets acquired or received (including those assets that meet the definition of, and recognition criteria for, intangible assets in IPSAS 31, *Intangible Assets*) and liabilities assumed. Such a transaction or event does not give rise to goodwill.**

   (c) **The assumption of a liability or a group of liabilities that does not constitute an operation. In such cases an entity shall identify and recognize the individual liabilities assumed.**

4. **The requirements of this Standard do not apply to the acquisition by an investment entity, as defined in IPSAS 35, *Consolidated Financial Statements*, of an investment in a controlled entity that is required to be measured at fair value through surplus or deficit.**

Definitions

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

   A <u>public sector combination</u> is the bringing together of separate operations into one public sector entity.

General Definitions Related to All Public Sector Combinations

For the purposes of this Standard, <u>equity interests</u> is used broadly to mean ownership interests of investor-owned entities and owner, member or participant interests of mutual entities.

An asset is <u>identifiable</u> if it either:

(a) **Is separable, i.e., is capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related binding arrangement, identifiable asset or liability, regardless of whether the entity intends to do so; or**

(b) **Arises from binding arrangements (including rights from contracts or other legal rights), regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.**

A mutual entity is an entity, other than an investor-owned entity, that provides dividends, lower costs or other economic benefits directly to its owners, members or participants. For example, a mutual insurance company, a credit union and a co-operative entity are all mutual entities.

An operation is an integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving an entity's objectives, by providing goods and/or services.

For the purposes of this Standard, owners is used broadly to include any party with quantifiable ownership interests in an operation. This includes, but is not limited to, holders of equity interests of investor-owned entities and owners or members of, or participants in, mutual entities.

A public sector combination under common control is a public sector combination in which all of the entities or operations involved are ultimately controlled by the same entity both before and after the public sector combination.

Definitions Related to Amalgamations

An amalgamation gives rise to a resulting entity and is either:

(a) **A public sector combination in which no party to the combination gains control of one or more operations; or**

(b) **A public sector combination in which one party to the combination gains control of one or more operations, and in which there is evidence that the combination has the economic substance of an amalgamation.**

(Paragraph AG1 provides additional guidance.)

The amalgamation date is the date on which the resulting entity obtains control of the combining operations.

A combining operation is an operation that combines with one or more other operations to form the resulting entity in an amalgamation.

A resulting entity is the entity that is the result of two or more operations combining in an amalgamation (paragraph AG1 provides additional guidance).

Definitions Relating to Acquisitions

An acquired operation is the operation that the acquirer gains control of in an acquisition.

An acquirer is the entity that gains control of one or more operations in an acquisition.

An acquisition is a public sector combination in which one party to the combination gains control of one or more operations, and there is evidence that the combination is not an amalgamation.

The acquisition date is the date on which the acquirer gains control of the acquired operation.

Contingent consideration is usually an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquired operation as part of the exchange for control of the acquired operation if specified future events occur or conditions are met. However, contingent consideration also may give the acquirer the right to the return of previously transferred consideration if specified conditions are met.

Goodwill is an asset representing the future economic benefits arising from other assets acquired in an acquisition that are not individually identified and separately recognized.

Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.

Identifying a Public Sector Combination

6. **An entity shall determine whether a transaction or other event is a public sector combination by applying the definitions in this Standard, which requires that the assets and liabilities constitute an operation. If the assets and liabilities do not constitute an operation, the entity shall account for the transaction or other event in accordance with other IPSASs. Paragraphs AG2–AG9 provide guidance on identifying a public sector combination.**

Classification of Public Sector Combinations

7. **If no party to a public sector combination gains control of one or more operations as a result of the combination, the combination shall be classified as an amalgamation. Paragraphs AG10–AG18 provide guidance on determining**

whether one party to a public sector combination gains control of one or more operations as a result of that combination.

8. **If one party to a public sector combination gains control of one or more operations as a result of the combination, an entity shall consider the economic substance of the combination in classifying the combination as either an amalgamation or an acquisition. A combination in which one party gains control of one or more operations shall be classified as an acquisition, unless it has the economic substance of an amalgamation.**

9. **In determining the classification of the public sector combination, an entity considers whether the resulting accounting treatment of the combination provides information that meets the objectives of financial reporting and that satisfies the qualitative characteristics (QCs).To assess the economic substance of the combination, an entity considers the indicators relating to consideration and to the decision-making process in paragraphs 12–13. These indicators, individually or in combination, will usually provide evidence that the economic substance of the combination is that of an amalgamation. A combination does not need to satisfy both of these indicators to be classified as an amalgamation. Paragraphs AG19–AG39 provide additional guidance.**

10. An analysis of the indicators relating to consideration and to the decision-making process in paragraphs 12–13 will usually produce a conclusive result and provide sufficient evidence about the economic substance of the public sector combination to determine whether the combination is an amalgamation. In such circumstances, the resulting classification and the associated accounting treatment will ensure that users have access to information that meets the objectives of financial reporting and that satisfies the QCs.

11. In exceptional circumstances, after applying the indicators in paragraphs 12–13, the results may be inconclusive or may not provide sufficient evidence about the economic substance of the public sector combination. In such circumstances, an entity also considers which classification would provide information that best meets the objectives of financial reporting and that best satisfies the QCs, having regard to paragraph 14. Paragraphs AG40–AG41 provide additional guidance.

Indicators that May Provide Evidence that the Combination is an Amalgamation

Indicators Relating to Consideration

12. The following indicators may provide evidence that the combination is an amalgamation:

    (a) Consideration is paid for reasons other than to compensate those with an entitlement to the net assets of a transferred operation for giving up that entitlement (paragraphs AG27–AG28 provide additional guidance);

    (b) Consideration is not paid to those with an entitlement to the net assets of a transferred operation (paragraphs AG29–AG30 provide additional guidance); or

    (c) Consideration is not paid because there is no-one (whether an individual or an entity) with an entitlement to the net assets of a transferred entity (paragraph AG31 provides additional guidance).

Indicators Relating to the Decision-Making Process

13. The following indicators may provide evidence that the combination is an amalgamation:

    (a) A public sector combination is imposed by a third party without any party to the combination being involved in the decision-making process (paragraphs AG32–AG35 provide additional guidance);

    (b) A public sector combination is subject to approval by each party's citizens through referenda (paragraph AG36 provides additional guidance); or

    (c) A public sector combination under common control occurs (paragraphs AG37–AG39 provide additional guidance).

Additional matters to be taken into account where the indicators relating to consideration and the decision-making process do not provide sufficient evidence to determine whether the combination is an amalgamation

14. The analysis of the indicators relating to consideration and the decision-making process may, in exceptional circumstances, produce inconclusive results or not provide sufficient evidence to determine whether the combination is an amalgamation, based on the economic substance of the public sector combination and the indicators in paragraphs 12–13. In such circumstances, an entity considers which classification and resulting accounting treatment would provide information that best meets the objectives of financial reporting. Paragraphs AG42–AG46 provide additional guidance. An entity also considers which classification and resulting accounting treatment would provide information that best satisfies the QCs of relevance, faithful representation, understandability, timeliness, comparability and verifiability. Paragraphs AG47–AG50 provide additional guidance.

Accounting for Amalgamations

15. **A resulting entity shall account for each amalgamation by applying the modified pooling of interests method of accounting.**

The Modified Pooling of Interests Method of Accounting

16. Applying the modified pooling of interests method of accounting requires:

    (a) Identifying the resulting entity;

    (b) Determining the amalgamation date;

    (c) Recognizing and measuring the identifiable assets received, the liabilities assumed and any non-controlling interest in the combining operations, consistent with the requirements in IPSASs; and

    (d) Recognizing and measuring the components of net assets/equity and other adjustments from an amalgamation.

Identifying the Resulting Entity

17. **For each amalgamation, a resulting entity shall be identified.**

18. Paragraph 5 of this Standard defines a resulting entity as "the entity that is the result of two or more operations combining in an amalgamation." The resulting entity shall thereafter be identified as the entity that obtains control of the combining operations as a result of the amalgamation.

Determining the Amalgamation Date

19. **The resulting entity shall identify the amalgamation date, which is the date on which it obtains control of the combining operations.**

20. The date on which the resulting entity obtains control of the combining operations may be the date on which the resulting entity receives the assets and assumes the liabilities of the combining operations. It is possible that the resulting entity will not receive legal title to the assets or assume legal responsibility for the liabilities of the combining operations. In these circumstances, the resulting entity will often obtain control of the assets and liabilities of the combining operations on the date on which responsibility for the assets and liabilities is formally delegated to the resulting entity. However, the resulting entity might obtain control on a different date. For example, legislation or a written agreement may provide that the resulting entity obtains control of the assets and liabilities of the combining operations on a specified date. A resulting entity shall consider all pertinent facts and circumstances in identifying the amalgamation date.

Recognizing and Measuring the Identifiable Assets, Liabilities Assumed and any Non-Controlling Interests in the Combining Operations

Recognition Principle

21. **As of the amalgamation date, the resulting entity shall recognize the identifiable assets, liabilities and any non-controlling interests that are recognized in the financial statements of the combining operations as of the amalgamation date. Recognition of identifiable assets and liabilities received is subject to the conditions specified in paragraphs 22–23.**

Recognition Conditions

22. **The effects of all transactions between the combining operations are eliminated in preparing the financial statements of the resulting entity (paragraphs AG51–AG52 provide related application guidance).**

23. To qualify for recognition as part of applying the modified pooling of interests method, the identifiable assets and liabilities must meet the definitions of assets and liabilities in the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* at the amalgamation date. For example, costs that the resulting entity expects, but is not obliged, to incur in the future to effect its plan to exit an activity of a combining operation or to terminate the employment of or relocate a combining operation's employees are not liabilities at the amalgamation date. Therefore, the resulting entity does not recognize those costs as part of applying the modified pooling of interests method. Instead, the resulting entity recognizes those costs in its post-combination financial statements in accordance with other IPSASs.

Classifying or Designating Assets and Liabilities in an Amalgamation

24. **At the amalgamation date, the resulting entity shall classify or designate the assets and liabilities received in an amalgamation using the classifications or designations previously applied by the combining operations. A resulting entity shall not adopt different classifications or designations on initial recognition, even if this is permitted by other IPSASs.**

25. In some situations, IPSASs provide for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or designations that the resulting entity shall make on the basis of the classifications or designations previously applied by the combining operations include but are not limited to:

    (a) Classification of particular financial assets and liabilities as measured at fair value or at amortized cost, in accordance with IPSAS 41, *Financial Instruments*;

    (b) Designation of a derivative instrument as a hedging instrument in accordance with IPSAS 41; and

    (c) Assessment of whether an embedded derivative should be separated from a host contract in accordance with IPSAS 41 (which is a matter of 'classification' as this Standard uses that term).

Measurement Principle

26. **The resulting entity shall measure the identifiable assets and liabilities of the combining operations at their carrying amounts in the financial statements of the combining operations as of the amalgamation date, subject to the requirements of paragraph 27 (paragraphs AG53–AG54 provide related application guidance).**

27. **As of the amalgamation date, the resulting entity shall adjust the carrying amounts of the identifiable assets and liabilities of the combining operations where required to conform to the resulting entity's accounting policies.**

28. The modified pooling of interests method results in a single combined resulting entity. A single uniform set of accounting policies, consistent with the requirements of IPSASs, is adopted by that entity, and the carrying amounts of the identifiable assets and liabilities of the combining operations are adjusted, where required, to conform to those accounting policies.

29. The resulting entity shall measure any non-controlling interests in a combining operation at their carrying amounts in the financial statements of that combining operation as of the amalgamation date, adjusted for the non-controlling interests' proportionate share of the adjustments made in accordance with paragraph 27.

30. Paragraphs 33–35 specify the types of identifiable assets and liabilities that include items for which this Standard provides limited exceptions to the measurement principle.

Exceptions to the Recognition or Measurement Principles

31. This Standard provides limited exceptions to its recognition and measurement principles. Paragraphs 32–35 specify both the particular items for which exceptions are provided and the nature of those exceptions. The resulting entity shall account for those items by applying the requirements in paragraphs 32–35, which will result in some items being:

    (a) Recognized either by applying recognition conditions in addition to those in paragraphs 22–23 or by applying the requirements of other IPSASs, with results that differ from applying the recognition principle and conditions.

    (b) Measured at an amount other than their amalgamation date carrying amounts.

Exception to the Recognition Principle

Licenses and similar rights previously granted by one combining operation to another combining operation

32. A license or similar right, previously granted by one combining operation to another combining operation and recognized as an intangible asset by the recipient combining operation shall be recognized by the resulting entity as an intangible asset. The license or similar right shall not be eliminated in accordance with paragraph 22 (paragraphs AG55–AG56 provide related application guidance).

Exceptions to Both the Recognition and Measurement Principles

Income Taxes (Where Included in the Terms of the Amalgamation)

33. Amalgamations involving public sector entities may result in a tax authority forgiving amounts of tax due as part of the terms of the amalgamation. The resulting entity shall not recognize any taxation items that are forgiven as a result of the terms of the amalgamation (paragraphs AG57–AG58 provide related application guidance).

34. The resulting entity shall recognize and measure any remaining taxation items included in or arising from an amalgamation in accordance with the relevant international or national accounting standard dealing with income taxes. The resulting entity shall recognize and measure any remaining revenue from taxation included in or arising from an amalgamation in accordance with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

Employee Benefits

35. The resulting entity shall recognize and measure a liability (or asset, if any) related to the combining operation's employee benefit arrangements in accordance with IPSAS 39, *Employee Benefits*.

Recognizing and Measuring Components of Net Assets/Equity Arising as a Result of an Amalgamation

36. **An amalgamation does not give rise to goodwill (paragraphs AG59–AG60 provide related application guidance).**

37. **The resulting entity shall recognize within net assets/equity amounts equal and opposite to the following items:**

    (a) **The carrying amounts of the combining operations' assets**;

    (b) **The carrying amounts of the combining operations' liabilities; and**

    (c) **The carrying amounts of the combining operations' non-controlling interests.**

38. **The resulting entity shall recognize within net assets/equity the corresponding adjustments in respect of:**

    (a) **The elimination of transactions between combining operations in accordance with paragraph 22;**

    (b) **Adjustments made to the carrying amounts of the identifiable assets and liabilities of the combining operations where required to conform to the resulting entity's accounting policies, in accordance with paragraph 27; and**

    (c) **Adjustments made in respect of the exceptions to the recognition and/or measurement principles, in accordance with paragraphs 32–35.**

39. **The resulting entity may present the amounts recognized within net assets/equity in accordance with paragraphs 37 and 38 as either:**

    (a) **A single opening balance; or**

    (b) **As separate components of net assets/equity.**

Measurement Period

40. **If the initial accounting for an amalgamation is incomplete by the end of the reporting period in which the amalgamation occurs, the resulting entity shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the resulting entity shall retrospectively adjust the provisional amounts recognized at the amalgamation date to reflect new information obtained about facts and circumstances that existed as of the amalgamation date and, if known, would have affected the measurement of the amounts recognized as of that date. During the measurement period, the resulting entity shall also recognize additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the amalgamation date and, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period ends as soon as the resulting entity receives the information it was seeking about facts and circumstances that existed as of the amalgamation date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the amalgamation date.**

41. The measurement period is the period after the amalgamation date during which the resulting entity may adjust the provisional amounts recognized for an amalgamation. The measurement period provides the resulting entity with a reasonable time to obtain the information necessary to identify and measure the identifiable assets, liabilities and any non-controlling interest in the combining operations as of the amalgamation date in accordance with the requirements of this Standard. The information necessary to identify and measure the identifiable assets, liabilities and any non-controlling interest in the combining operations will generally be available at the amalgamation date. However, this may not be the case where combining operations have previously prepared their financial statements using different accounting policies.

42. The resulting entity recognizes an increase (decrease) in the provisional amount recognized for an identifiable asset (liability) by adjusting components of net assets/equity recognized in accordance with paragraphs 37–38. However, new information obtained during the measurement period may sometimes result in an adjustment to the provisional amount of more than one asset or liability. For example, the resulting entity might have assumed a liability to pay damages related to an accident in one of the combining operation's facilities, part or all of which are covered by the combining operation's

liability insurance policy. If the resulting entity obtains new information during the measurement period about the carrying amount of that liability, the adjustment to the gain or loss resulting from a change to the provisional amount recognized for the liability would be offset (in whole or in part) by a corresponding adjustment to the gain or loss resulting from a change to the provisional amount recognized for the claim receivable from the insurer.

43. During the measurement period, the resulting entity shall recognize adjustments to the provisional amounts as if the accounting for the amalgamation had been completed at the amalgamation date. Thus, the resulting entity shall revise comparative information for prior periods presented in financial statements as needed, including making any change in depreciation or amortization recognized in completing the initial accounting.

44. After the measurement period ends, the resulting entity shall revise the accounting for an amalgamation only to correct an error in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Amalgamation-Related Costs

45. Amalgamation-related costs are costs the resulting entity or combining operations incur to effect an amalgamation. Those costs include advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs; and any costs of registering and issuing debt and equity securities. The resulting entity and combining operations shall account for amalgamation-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognized in accordance with IPSAS 28, *Financial Instruments: Presentation*, and IPSAS 41, *Financial Instruments*.

Subsequent Measurement and Accounting

46. In general, a resulting entity shall subsequently measure and account for assets and liabilities received and equity instruments issued in an amalgamation in accordance with other applicable IPSASs for those items, depending on their nature. However, this Standard provides guidance on subsequently measuring and accounting for the following assets received and liabilities assumed or incurred in an amalgamation:

(a) Licenses and similar rights previously granted by one combining operation to another combining operation;

(b) Transfers, concessionary loans and similar benefits received by a combining operation on the basis of criteria that change as a result of an amalgamation; and

(c) Income taxes (where not included in the terms of the amalgamation).

Licenses and Similar Rights Previously Granted by One Combining Operation to Another Combining Operation

47. A license or similar right, previously granted by one combining operation to another combining operation and recognized as an intangible asset shall be amortized over the remaining period of the binding arrangement in which the right was granted, where the right was granted for a finite period. Where the right was granted for an indefinite period, the resulting entity shall test the right for impairment at least annually, and whenever there is an indication that the right may be impaired. A resulting entity that subsequently sells this license or similar right to a third party shall include the carrying amount of the intangible asset in determining the gain or loss on the sale.

Transfers, Concessionary Loans and Similar Benefits Received by a Combining Operation on the Basis of Criteria that May Change as a Result of an Amalgamation

48. A transfer, concessionary loan or similar benefit, previously received by a combining operation on the basis of criteria that change as a result of an amalgamation, shall be reassessed prospectively in accordance with other IPSASs (paragraphs AG61–AG63 provide related application guidance).

Income Taxes (Where not Included in the Terms of the Amalgamation)

49. Amalgamations involving public sector entities may result in a tax authority forgiving amounts of tax subsequent to the amalgamation. The resulting entity shall account for the tax forgiven prospectively in accordance with the relevant international or national accounting standard dealing with income taxes.

Presentation of Financial Statements

50. **Except where a resulting entity is not a new entity following a public sector combination, the resulting entity's first set of financial statements following the amalgamation shall comprise:**

(a) **An opening statement of financial position as of the amalgamation date;**

(b) **A statement of financial position as at the reporting date;**

(c) **A statement of financial performance for the period from the amalgamation date to the reporting date;**

(d) **A statement of changes in net assets/equity for the period from the amalgamation date to the reporting date;**

(e) **A cash flow statement for the period from the amalgamation date to the reporting date;**

(f) **If the entity makes publicly available its approved budget, a comparison of budget and actual amounts for the period from the amalgamation date to the reporting date, either as a separate additional financial statement or as a budget column in the financial statements; and**

(g) **Notes, comprising a summary of significant accounting policies and other explanatory notes.**

51. **Where a resulting entity is not a new entity following a public sector combination, the resulting entity shall disclose:**

(a) **The amounts recognized of each major class of assets and liabilities, and components of net assets/equity from combining operations included in the resulting entity;**

(b) **Any adjustments made to components of net assets/equity where required to conform the accounting policies of the combining operations with those of the resulting entity; and**

(c) **Any adjustments made to eliminate transactions between the combining operations.**

52. Subject to the requirements in paragraphs 54 and 56, the resulting entity is permitted but not required to present financial statements for periods prior to the amalgamation date (paragraphs AG64–AG65 provide related application guidance). Where a resulting entity elects to present financial statements for periods prior to the amalgamation date, it shall disclose the information required by paragraph 54(g).

Disclosures

53. **The resulting entity shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of an amalgamation.**

54. To meet the objective in paragraph 53, the resulting entity shall disclose the following information for each amalgamation that occurs during the reporting period:

(a) The name and a description of each combining operation.

(b) The amalgamation date.

(c) The primary reasons for the amalgamation including, where applicable, the legal basis for the amalgamation.

(d) The amounts recognized as of the amalgamation date for each major class of assets and liabilities transferred.

(e) The adjustments made to the carrying amounts of assets and liabilities recorded by each combining operation as of the amalgamation date:

(i) To eliminate the effect of transactions between combining operations in accordance with paragraph 22; and

(ii) To conform to the resulting entity's accounting policies in accordance with paragraph 27.

(f) An analysis of net assets/equity, including any components that are presented separately, and any significant adjustments such as revaluation surpluses or deficits, recognized in accordance with paragraphs 37–38.

(g) If a resulting entity elects to present financial statements for periods prior to the amalgamation date in accordance with paragraph 52, the resulting entity shall disclose the following information for each combining operation:

(i) A statement of financial position as at the end of the prior period(s);

(ii) A statement of financial performance for the prior period(s);

(iii) A statement of changes in net assets/equity for the prior period(s);

(iv) A cash flow statement for the prior period(s); and

(v) Notes, comprising a summary of significant accounting policies and other explanatory notes.

The resulting entity shall not restate this information, but shall disclose the information on the same basis as used in the combining operations' financial statements. The resulting entity shall disclose the basis on which this information is presented.

(h) If, at the time the financial statements of the resulting entity are authorized for issue, the last reporting date of any of the combining operations does not immediately precede the amalgamation date, the resulting entity shall disclose the following information:

(i) The amounts of revenue and expense, and the surplus or deficit of each combining operation from the last reporting date of the combining operations until the amalgamation date. The amounts of revenue shall be analyzed in a manner appropriate to the entity's operations, in accordance with paragraph 108 of IPSAS 1, *Presentation of Financial Statements*. The amounts of expense shall be analyzed using a classification based on either the nature of expenses or their function within the entity, whichever provides information that is faithfully representative and more relevant, in accordance with paragraph 109 of IPSAS 1.

(ii) The amounts reported by each combining operation immediately prior to the amalgamation date for each major class of assets and liabilities.

(iii) The amounts reported by each combining operation immediately prior to the amalgamation date in net assets/equity.

The resulting entity is not required to disclose this information where it has elected to present financial statements for periods prior to the amalgamation date as specified in subparagraph (g) above.

55. **The resulting entity shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognized in the current reporting period that relate to amalgamations that occurred in the period or previous reporting periods.**

56. To meet the objective in paragraph 55, the resulting entity shall disclose the following information:

(a) If the initial accounting for an amalgamation is incomplete (see paragraph 40) for particular assets or liabilities, and the amounts recognized in the financial statements for the amalgamation thus have been determined only provisionally:

(i) The reasons why the initial accounting for the amalgamation is incomplete;

(ii) The assets or liabilities for which the initial accounting is incomplete; and

(iii) The nature and amount of any measurement period adjustments recognized during the reporting period in accordance with paragraph 43.

(b) If amounts of tax due are forgiven as a result of the terms of the amalgamation (see paragraphs 33–34):

(i) The amount of tax due that was forgiven; and

(ii) Where the resulting entity is the tax authority, details of the adjustment made to tax receivable.

57. If the specific disclosures required by this and other IPSASs do not meet the objectives set out in paragraphs 53 and 55, the resulting entity shall disclose whatever additional information is necessary to meet those objectives.

Accounting for Acquisitions

58. **An acquirer shall account for each acquisition by applying the acquisition method of accounting.**

The Acquisition Method of Accounting

59. Applying the acquisition method of accounting requires:

(a) Identifying the acquirer;

(b) Determining the acquisition date;

(c) Recognizing and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired operation; and

(d) Recognizing and measuring goodwill, a gain or a loss from an acquisition.

Identifying the Acquirer

60. **For each acquisition, the party to the combination that gains control of one or more operations shall be identified as the acquirer.**

61. The party to the combination that gains control of one or more operations is identified when determining the classification of the public sector combination in accordance with paragraphs 7, 8 and AG10–AG18.

Determining the Acquisition Date

62. **The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquired operation.**

63. The date on which the acquirer obtains control of the acquired operation is generally the date on which the acquirer legally transfers the consideration and/or acquires the assets and assumes the liabilities of the acquired operation—the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date. For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquired operation on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date.

Recognizing and Measuring the Identifiable Assets Acquired, the Liabilities Assumed and any Non-Controlling Interest in the Acquired Operation

Recognition Principle

64. **As of the acquisition date, the acquirer shall recognize, separately from any goodwill recognized, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired operation. Recognition of identifiable assets acquired and liabilities assumed is subject to the conditions specified in paragraphs 65 and 66.**

Recognition Conditions

65. To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* at the acquisition date, and be capable of being measured in a way that achieves the qualitative characteristics and takes account of constraints on information in general purpose financial reporting. For example, costs the acquirer expects but is not obliged to incur in the future to effect its plan to exit an activity of an acquired operation or to terminate the employment of or relocate an acquired operation's employees are not liabilities at the acquisition date. Therefore, the acquirer does not recognize those costs as part of applying the acquisition method. Instead, the acquirer recognizes those costs in its post-combination financial statements in accordance with other IPSASs.

66. In addition, to qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must be part of what the acquirer and the acquired operation (or its former owners) exchanged in the acquisition transaction rather than the result of separate transactions. The acquirer shall apply the guidance in paragraphs 109–111 to determine which assets acquired or liabilities assumed are part of the exchange for the acquired operation and which, if any, are the result of separate transactions to be accounted for in accordance with their nature and the applicable IPSASs.

67. The acquirer's application of the recognition principle and conditions may result in recognizing some assets and liabilities that the acquired operation had not previously recognized as assets and liabilities in its financial statements. For example, the acquirer recognizes the acquired identifiable intangible assets, such as a patent or a customer relationship, that the acquired operation did not recognize as assets in its financial statements because it developed them internally and charged the related costs to expense.

68. Paragraphs AG75–AG84 provide guidance on recognizing intangible assets. Paragraphs 76–82B specify the types of identifiable assets and liabilities that include items for which this Standard provides limited exceptions to the recognition principle and conditions.

Classifying or Designating Identifiable Assets Acquired and Liabilities Assumed in an Acquisition

69. **At the acquisition date, the acquirer shall classify or designate the identifiable assets acquired and liabilities assumed as necessary to subsequently apply other IPSASs. The acquirer shall make those classifications or designations on the basis of the terms of the binding arrangement (including contractual terms), economic conditions, its operating or accounting policies and other pertinent conditions as they exist at the acquisition date.**

70. In some situations, IPSASs provide for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or designations that the acquirer shall make on the basis of the pertinent conditions as they exist at the acquisition date include but are not limited to:

(a) Classification of particular financial assets and liabilities as measured at fair value through surplus or deficit or at amortized cost, or as a financial asset measured at fair value through net assets/equity in accordance with IPSAS 41;

(b) Designation of a derivative instrument as a hedging instrument in accordance with IPSAS 41; and

(c) Assessment of whether an embedded derivative should be separated from a host contract in accordance with IPSAS 41 (which is a matter of 'classification' as this Standard uses that term).

71. This Standard provides two exceptions to the principle in paragraph 69:

(a) Classification of a lease contract in which the acquiree is the lessor as either an operating lease or a finance lease in accordance with IPSAS 43, *Leases*; and

(b) Classification of a contract as an insurance contract in accordance with the relevant international or national accounting standard dealing with insurance contracts.

The acquirer shall classify those binding arrangements on the basis of the terms and other factors at the inception of the binding arrangement (or, if the terms of the binding arrangement have been modified in a manner that would change its classification, at the date of that modification, which might be the acquisition date).

Measurement Principle

72. **The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.**

73. For each acquisition, the acquirer shall measure at the acquisition date components of non-controlling interests in the acquired operation that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either:

(a) Fair value; or

(b) The present ownership instruments' proportionate share in the recognized amounts of the acquired operation's identifiable net assets.

All other components of non-controlling interests shall be measured at their acquisition-date fair values, unless another measurement basis is required by IPSASs.

74. Paragraphs 78–84 specify the types of identifiable assets and liabilities that include items for which this Standard provides limited exceptions to the measurement principle.

Exceptions to the Recognition or Measurement Principles

75. This Standard provides limited exceptions to its recognition and measurement principles. Paragraphs 76–84 specify both the particular items for which exceptions are provided and the nature of those exceptions. The acquirer shall account for those items by applying the requirements in paragraphs 76–84, which will result in some items being:

(a) Recognized either by applying recognition conditions in addition to those in paragraphs 65–66 or by applying the requirements of other IPSASs, with results that differ from applying the recognition principle and conditions.

(b) Measured at an amount other than their acquisition-date fair values.

Exception to the Recognition Principle

Contingent Liabilities

76. IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, defines a contingent liability as:

(a) A possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

(b) A present obligation that arises from past events, but is not recognized because:

(i) It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or

(ii) The amount of the obligation cannot be measured with sufficient reliability.

77. The requirements in IPSAS 19 do not apply in determining which contingent liabilities to recognize as of the acquisition date. Instead, the acquirer shall recognize as of the acquisition date a contingent liability assumed in an acquisition where

consideration is transferred if it is a present obligation that arises from past events and its fair value can be measured reliably[1]. Therefore, contrary to IPSAS 19, the acquirer recognizes a contingent liability assumed in an acquisition where consideration is transferred at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation. Paragraph 115 provides guidance on the subsequent accounting for contingent liabilities.

Exceptions to Both the Recognition and Measurement Principles

Income Taxes (Where Included in the Terms of the Acquisition)

78. Acquisitions by a public sector entity may result in a tax authority forgiving amounts of tax due as part of the terms of the acquisition. The acquirer shall not recognize any taxation items that are forgiven as a result of the terms of the acquisition (paragraphs AG85–AG87 provide related application guidance).

79. The acquirer shall recognize and measure any remaining taxation items included in or arising from an acquisition in accordance with the relevant international or national accounting standard dealing with income taxes. The acquirer entity shall recognize and measure any remaining revenue from taxation included in or arising from an acquisition in accordance with IPSAS 23.

Employee Benefits

80. The acquirer shall recognize and measure a liability (or asset, if any) related to the acquired operation's employee benefit arrangements in accordance with IPSAS 39.

Indemnification Assets

81. The seller in an acquisition may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset or liability. For example, the seller may indemnify the acquirer against losses above a specified amount on a liability arising from a particular contingency; in other words, the seller will guarantee that the acquirer's liability will not exceed a specified amount. As a result, the acquirer obtains an indemnification asset. The acquirer shall recognize an indemnification asset at the same time that it recognizes the indemnified item measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts. Therefore, if the indemnification relates to an asset or a liability that is recognized at the acquisition date and measured at its acquisition-date fair value, the acquirer shall recognize the indemnification asset at the acquisition date measured at its acquisition-date fair value. For an indemnification asset measured at fair value, the effects of uncertainty about future cash flows because of collectibility considerations are included in the fair value measure and a separate valuation allowance is not necessary (paragraph AG88 provides related application guidance).

82. In some circumstances, the indemnification may relate to an asset or a liability that is an exception to the recognition or measurement principles. For example, an indemnification may relate to a contingent liability that is not recognized at the acquisition date because its fair value is not reliably measurable at that date. Alternatively, an indemnification may relate to an asset or a liability, for example, one that results from an employee benefit, that is measured on a basis other than acquisition-date fair value. In those circumstances, the indemnification asset shall be recognized and measured using assumptions consistent with those used to measure the indemnified item, subject to management's assessment of the collectibility of the indemnification asset and any contractual limitations on the indemnified amount. Paragraph 116 provides guidance on the subsequent accounting for an indemnification asset.

Leases in Which the Acquiree is the Lessee

82A. The acquirer shall recognize right-of-use assets and lease liabilities for leases identified in accordance with IPSAS 43 in which the acquiree is the lessee. The acquirer is not required to recognize right-of-use assets and lease liabilities for:

(a) Leases for which the lease term (as defined in IPSAS 43) ends within 12 months of the acquisition date; or

(b) Leases for which the underlying asset is of low value (as described in paragraphs AG4–AG9 of IPSAS 43).

82B. The acquirer shall measure the lease liability at the present value of the remaining lease payments (as defined in IPSAS 43) as if the acquired lease were a new lease at the acquisition date. The acquirer shall measure the right-of-use asset at the same amount as the lease liability, adjusted to reflect favorable or unfavorable terms of the lease when compared with market terms.

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[1] Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent. Paragraph BC16 of IPSAS 1 discusses the transitional approach to the explanation of reliability.

Exceptions to the Measurement Principle

Reacquired Rights

83. The acquirer shall measure the value of a reacquired right recognized as an intangible asset on the basis of the remaining term of the related binding arrangement regardless of whether market participants would consider potential renewals of binding arrangements when measuring its fair value. Paragraphs AG79–AG80 provide related application guidance.

Share-Based Payment Transactions

84. The acquirer shall measure a liability or an equity instrument related to share-based payment transactions of the acquired operation or the replacement of an acquired operation's share-based payment transactions with share-based payment transactions of the acquirer in accordance with the relevant international or national accounting standard dealing with share-based payments.

Recognizing and Measuring Goodwill or a Gain from a Bargain Purchase

85. **The acquirer shall recognize goodwill as of the acquisition date measured as the excess of (a) over (b) below, subject to the requirements of paragraph 86:**

(a) **The aggregate of:**

(i) **The consideration transferred measured in accordance with this Standard, which generally requires acquisition-date fair value (see paragraph 95);**

(ii) **The amount of any non-controlling interest in the acquired operation measured in accordance with this Standard; and**

(iii) **In an acquisition achieved in stages (see paragraphs 99–100), the acquisition-date fair value of the acquirer's previously held equity interest in the acquired operation.**

(b) **The net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this Standard.**

86. **The acquirer shall recognize goodwill only to the extent that the acquisition will result in:**

(a) **The generation of cash inflows (such as the acquisition of a cash-generating operation); and/or**

(b) **A reduction in the net cash outflows of the acquirer.**

An acquirer shall recognize any further excess of (a) over (b) in paragraph 85 above as a loss in surplus or deficit. Paragraph AG93 provides related application guidance.

87. In an acquisition in which the acquirer and the acquired operation (or its former owners) exchange only equity interests, the acquisition-date fair value of the acquired operation's equity interests may be more reliably measurable than the acquisition-date fair value of the acquirer's equity interests. If so, the acquirer shall determine the amount of goodwill by using the acquisition-date fair value of the acquired operation's equity interests instead of the acquisition-date fair value of the equity interests transferred. To determine the amount of goodwill in an acquisition in which no consideration is transferred, the acquirer shall use the acquisition-date fair value of the acquirer's interest in the acquired operation in place of the acquisition-date fair value of the consideration transferred (paragraph 85(a)(i)). Paragraph AG94 provides related application guidance.

Bargain Purchases

88. Occasionally in a public sector combination classified as an acquisition, an acquirer will make a bargain purchase, which is an acquisition in which the amount in paragraph 85(b) exceeds the aggregate of the amounts specified in paragraph 85(a). If that excess remains after applying the requirements in paragraph 90, the acquirer shall recognize the resulting gain in surplus or deficit on the acquisition date. The gain shall be attributed to the acquirer.

89. A bargain purchase might happen, for example, in an acquisition that is a forced sale in which the seller is acting under economic compulsion. However, the recognition or measurement exceptions for particular items discussed in paragraphs 76–84 may also result in recognizing a gain (or change the amount of a recognized gain) on a bargain purchase.

90. Before recognizing a gain on a bargain purchase, the acquirer shall reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed and shall recognize any additional assets or liabilities that are identified in that review. The acquirer shall then review the procedures used to measure the amounts this Standard requires to be recognized at the acquisition date for all of the following:

(a) The identifiable assets acquired and liabilities assumed;

(b) The non-controlling interest in the acquired operation, if any;

(c) For an acquisition achieved in stages, the acquirer's previously held equity interest in the acquired operation; and

(d) The consideration transferred.

The objective of the review is to ensure that the measurements appropriately reflect consideration of all available information as of the acquisition date.

91. In the public sector, an entity sometimes obtains control of an operation in a non-exchange transaction in which it transfers consideration that is not approximately equal to the fair value of the acquired operation. Such circumstances include, but are not limited to:

(a) Compensated seizures of operations or entities; and

(b) The transfer of an operation to the acquirer by a donor for nominal consideration.

92. Where the economic substance of the public sector combination is that of an acquisition, such non-exchange acquisitions are treated as bargain purchases and accounted for in accordance with paragraphs 88–90.

A Non-Exchange Acquisition Without the Transfer of Consideration

93. In the public sector, an entity sometimes obtains control of an operation in a non-exchange transaction in which it transfers no consideration. Such circumstances include, but are not limited to:

(a) Uncompensated seizures of operations or entities (also known as forced nationalizations).

(b) The transfer of an operation to the entity by a donor for no consideration. Such transfers may take the form of a bequest.

And

(c) The transfer of an operation to the entity where the operation has net liabilities. The entity may accept the transfer of net liabilities to prevent the cessation of the operation. Such transactions are sometimes known as "bailouts".

94. Where the economic substance of the public sector combination is that of an acquisition, the acquirer that obtains control of an acquired operation in a non-exchange transaction in which it transfers no consideration does not recognize goodwill. The acquirer recognizes a gain or a loss in surplus or deficit in accordance with paragraph 86.

Consideration Transferred

95. The consideration transferred in an acquisition shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquired operation and the equity interests issued by the acquirer. (However, any portion of the acquirer's share-based payment awards exchanged for awards held by the acquired operation's employees that is included in consideration transferred in the acquisition shall be measured in accordance with paragraph 84 rather than at fair value.) Examples of potential forms of consideration include cash, other assets, an operation or a controlled entity of the acquirer, contingent consideration, ordinary or preference equity instruments, options, warrants and member interests of mutual entities.

96. The consideration transferred may include assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date (for example, non-monetary assets or an operation of the acquirer). If so, the acquirer shall remeasure the transferred assets or liabilities to their fair values as of the acquisition date and recognize the resulting gains or losses, if any, in surplus or deficit. However, sometimes the transferred assets or liabilities remain within the combined entity after the acquisition (for example, because the assets or liabilities were transferred to the acquired operation rather than to its former owners), and the acquirer therefore retains control of them. In that situation, the acquirer shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date and shall not recognize a gain or loss in surplus or deficit on assets or liabilities it controls both before and after the acquisition.

Contingent Consideration

97. The consideration the acquirer transfers in exchange for the acquired operation includes any asset or liability resulting from a contingent consideration arrangement (see paragraph 95). The acquirer shall recognize the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquired operation.

98. The acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as a component of net assets/equity on the basis of the definitions of an equity instrument and a financial liability in paragraph 9 of IPSAS 28. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 117 provides guidance on the subsequent accounting for contingent consideration.

An Acquisition Achieved in Stages

99. An acquirer sometimes obtains control of an acquired operation in which it held an equity interest immediately before the acquisition date. For example, on 31 December 20X1, Entity A holds a 35 percent non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40 percent interest in Entity B, which gives it control of Entity B. This Standard refers to such a transaction as an acquisition achieved in stages, sometimes also referred to as a step acquisition.

100. In an acquisition achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquired operation at its acquisition-date fair value and recognize the resulting gain or loss, if any, in surplus or deficit or in net assets/equity, as appropriate. In prior reporting periods, the acquirer may have recognized changes in the value of its equity interest in the acquired operation in net assets/equity. If so, the amount that was recognized in net assets/equity shall be recognized on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

100A. When a party to a joint arrangement (as defined in IPSAS 37, *Joint Arrangements*) obtains control of an operation that is a joint operation (as defined in IPSAS 37), and had rights to the assets and obligations for the liabilities relating to that joint operation immediately before the acquisition date, the transaction is an acquisition achieved in stages. The acquirer shall therefore apply the requirements for an acquisition achieved in stages, including remeasuring its previously held interest in the joint operation in the manner described in paragraph 100. In doing so, the acquirer shall remeasure its entire previously held interest in the joint operation.

Additional Guidance for Applying the Acquisition Method Where an Acquisition is Achieved Through Changes in Voting Rights, by Contract Alone, and Similar Circumstances in Which no Consideration is Transferred

An Acquisition Achieved Through Changes in Voting Rights, by Contract Alone, and Similar Circumstances not Involving the Transfer of Consideration

101. An acquirer sometimes obtains control of an acquired operation without transferring consideration. The acquisition method of accounting for an acquisition applies to those public sector combinations. Such circumstances include:

(a) The acquired operation repurchases a sufficient number of its own shares for an existing investor (the acquirer) to obtain control.

(b) Minority veto rights lapse that previously kept the acquirer from controlling an acquired operation in which the acquirer held the majority voting rights.

(c) The acquirer and acquired operation agree to combine their operations by contract alone. The acquirer transfers no consideration in exchange for control of an acquired operation and holds no quantifiable ownership interests in the acquired operation, either on the acquisition date or previously.

102. In an acquisition achieved by contract alone, the acquirer shall attribute to the owners of the acquired operation the amount of the acquired operation's net assets recognized in accordance with this Standard. In other words, the quantifiable ownership interests in the acquired operation held by parties other than the acquirer are a non-controlling interest in the acquirer's post-combination financial statements even if the result is that all of the quantifiable ownership interests in the acquired operation are attributed to the non-controlling interest.

Measurement Period

103. **If the initial accounting for an acquisition is incomplete by the end of the reporting period in which the acquisition occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognized at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognized as of that date. During the measurement period, the acquirer shall also recognize additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the**

acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

104. The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognized for an acquisition. The measurement period provides the acquirer with a reasonable time to obtain the information necessary to identify and measure the following as of the acquisition date in accordance with the requirements of this Standard:

(a) The identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquired operation;

(b) The consideration transferred for the acquired operation (or the other amount used in measuring goodwill);

(c) In an acquisition achieved in stages, the equity interest in the acquired operation previously held by the acquirer; and

(d) The resulting goodwill, loss, or gain on a bargain purchase.

105. The acquirer shall consider all pertinent factors in determining whether information obtained after the acquisition date should result in an adjustment to the provisional amounts recognized or whether that information results from events that occurred after the acquisition date. Pertinent factors include the date when additional information is obtained and whether the acquirer can identify a reason for a change to provisional amounts. Information that is obtained shortly after the acquisition date is more likely to reflect circumstances that existed at the acquisition date than is information obtained several months later. For example, unless an intervening event that changed its fair value can be identified, the sale of an asset to a third party shortly after the acquisition date for an amount that differs significantly from its provisional fair value measured at that date is likely to indicate an error in the provisional amount.

106. The acquirer recognizes an increase (decrease) in the provisional amount recognized for an identifiable asset (liability) by means of a decrease (increase) in goodwill. However, new information obtained during the measurement period may sometimes result in an adjustment to the provisional amount of more than one asset or liability. For example, the acquirer might have assumed a liability to pay damages related to an accident in one of the acquired operation's facilities, part or all of which are covered by the acquired operation's liability insurance policy. If the acquirer obtains new information during the measurement period about the acquisition-date fair value of that liability, the adjustment to goodwill resulting from a change to the provisional amount recognized for the liability would be offset (in whole or in part) by a corresponding adjustment to goodwill resulting from a change to the provisional amount recognized for the claim receivable from the insurer.

107. During the measurement period, the acquirer shall recognize adjustments to the provisional amounts as if the accounting for the acquisition had been completed at the acquisition date. Thus, the acquirer shall revise comparative information for prior periods presented in financial statements as needed, including making any change in depreciation, amortization or other income effects recognized in completing the initial accounting.

108. After the measurement period ends, the acquirer shall revise the accounting for an acquisition only to correct an error in accordance with IPSAS 3.

Determining what is Part of the Acquisition Transaction

109. **The acquirer and the acquired operation may have a pre-existing relationship or other arrangement before negotiations for the acquisition began, or they may enter into an arrangement during the negotiations that is separate from the acquisition. In either situation, the acquirer shall identify any amounts that are not part of what the acquirer and the acquired operation (or its former owners) exchanged in the acquisition, i.e., amounts that are not part of the exchange for the acquired operation. The acquirer shall recognize as part of applying the acquisition method only the consideration transferred for the acquired operation and the assets acquired and liabilities assumed in the exchange for the acquired operation. Separate transactions shall be accounted for in accordance with the relevant IPSASs.**

110. A transaction entered into by or on behalf of the acquirer or primarily for the benefit of the acquirer or the combined entity, rather than primarily for the benefit of the acquired operation (or its former owners) before the acquisition, is likely to be a separate transaction. The following are examples of separate transactions that are not to be included in applying the acquisition method:

(a) A transaction that in effect settles pre-existing relationships between the acquirer and acquired operation;

(b) A transaction that remunerates employees or former owners of the acquired operation for future services; and

(c) A transaction that reimburses the acquired operation or its former owners for paying the acquirer's acquisition-related costs.

Paragraphs AG99–AG106 provide related application guidance.

Acquisition-Related Costs

111. Acquisition-related costs are costs the acquirer incurs to effect an acquisition. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognized in accordance with IPSAS 28 and IPSAS 41.

Subsequent Measurement and Accounting

112. **In general, an acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred and equity instruments issued in an acquisition in accordance with other applicable IPSASs for those items, depending on their nature. However, this Standard provides guidance on subsequently measuring and accounting for the following assets acquired, liabilities assumed or incurred and equity instruments issued in an acquisition:**

(a) **Reacquired rights;**

(b) **Contingent liabilities recognized as of the acquisition date;**

(c) **Indemnification assets;**

(d) **Contingent consideration; and**

(e) **Income taxes (where not included in the terms of the acquisition).**

Paragraphs AG107–AG108 provide related application guidance.

Reacquired Rights

113. A reacquired right recognized as an intangible asset shall be amortized over the remaining period of the binding arrangement in which the right was granted, where the right was granted for a finite period. Where the right was granted for an indefinite period, the resulting entity shall test the right for impairment at least annually, and whenever there is an indication that the right may be impaired. An acquirer that subsequently sells a reacquired right to a third party shall include the carrying amount of the intangible asset in determining the gain or loss on the sale.

Transfers, Concessionary Loans and Similar Benefits Received by an Acquirer or Acquired Operation on the Basis of Criteria that May Change as a Result of an Acquisition

114. A transfer, concessionary loan or similar benefit, previously received by an acquirer or an acquired operation on the basis of criteria that change as a result of an acquisition, shall be reassessed prospectively in accordance with other IPSASs (paragraphs AG109–AG111 provide related application guidance).

Contingent Liabilities

115. After initial recognition and until the liability is settled, cancelled or expires, the acquirer shall measure a contingent liability recognized in an acquisition at the higher of:

(a) The amount that would be recognized in accordance with IPSAS 19; and

(b) The amount initially recognized less, if appropriate, cumulative amortization recognized in accordance with IPSAS 9, *Revenue from Exchange Transactions*.

This requirement does not apply to contracts accounted for in accordance with IPSAS 41, *Financial Instruments*.

Indemnification Assets

116. At the end of each subsequent reporting period, the acquirer shall measure an indemnification asset that was recognized at the acquisition date on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount and, for an indemnification asset that is not subsequently measured at its fair value, management's assessment of

the collectibility of the indemnification asset. The acquirer shall derecognize the indemnification asset only when it collects the asset, sells it or otherwise loses the right to it.

Contingent Consideration

117. Some changes in the fair value of contingent consideration that the acquirer recognizes after the acquisition date may be the result of additional information that the acquirer obtained after that date about facts and circumstances that existed at the acquisition date. Such changes are measurement period adjustments in accordance with paragraphs 103–107. However, changes resulting from events after the acquisition date, such as meeting an earnings target, reaching a specified share price or reaching a milestone on a research and development project, are not measurement period adjustments. The acquirer shall account for changes in the fair value of contingent consideration that are not measurement period adjustments as follows:

(a) Contingent consideration classified as a component of net assets/equity shall not be remeasured and its subsequent settlement shall be accounted for within net assets/equity.

(b) Other contingent consideration that:

(i) Is within the scope of IPSAS 41 shall be measured at fair value at each reporting date and changes in fair value shall be recognized in surplus or deficit in accordance with IPSAS 41.

(ii) Is not within the scope of IPSAS 41 shall be measured at fair value at each reporting date and changes in fair value shall be recognized in surplus or deficit.

Income Taxes (Where not Included in the Terms of the Acquisition)

118. Acquisitions involving public sector entities may result in a tax authority forgiving amounts of tax subsequent to the acquisition. The acquirer shall account for the tax forgiven prospectively in accordance with the relevant international or national accounting standard dealing with income taxes.

Disclosures

119. **The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of an acquisition that occurs either:**

(a) **During the current reporting period; or**

(b) **After the end of the reporting period but before the financial statements are authorized for issue.**

120. To meet the objective in paragraph 119, the acquirer shall disclose the following information for each acquisition that occurs during the reporting period:

(a) The name and a description of the acquired operation.

(b) The acquisition date.

(c) The percentage of voting equity interests or equivalent acquired.

(d) The primary reasons for the acquisition and a description of how the acquirer obtained control of the acquired operation including, where applicable, the legal basis for the acquisition.

(e) A qualitative description of the factors that make up the goodwill recognized, such as expected synergies from combining the operations of the acquired operation and the acquirer, intangible assets that do not qualify for separate recognition or other factors.

(f) The acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:

(i) Cash;

(ii) Other tangible or intangible assets, including an operation or controlled entity of the acquirer;

(iii) Liabilities incurred, for example, a liability for contingent consideration; and

(iv) Equity interests of the acquirer, including the number of instruments or interests issued or issuable and the method of measuring the fair value of those instruments or interests.

(g) For contingent consideration arrangements and indemnification assets:

(i) The amount recognized as of the acquisition date;

   (ii) A description of the arrangement and the basis for determining the amount of the payment; and

   (iii) An estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.

(h) For acquired receivables:

   (i) The fair value of the receivables;

   (ii) The gross amounts receivable in accordance with a binding arrangement; and

   (iii) The best estimate at the acquisition date of the cash flows in accordance with a binding arrangement not expected to be collected.

   The disclosures shall be provided by major class of receivable, such as loans, leases and any other class of receivables.

(i) The amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed.

(j) For each contingent liability recognized in accordance with paragraph 77, the information required in paragraph 98 of IPSAS 19. If a contingent liability is not recognized because its fair value cannot be measured reliably, the acquirer shall disclose:

   (i) The information required by paragraph 100 of IPSAS 19; and

   (ii) The reasons why the liability cannot be measured reliably.

(k) The total amount of goodwill that is expected to be deductible for tax purposes.

(l) For transactions that are recognized separately from the acquisition of assets and assumption of liabilities in the acquisition in accordance with paragraph 109:

   (i) A description of each transaction;

   (ii) How the acquirer accounted for each transaction;

   (iii) The amounts recognized for each transaction and the line item in the financial statements in which each amount is recognized; and

   (iv) If the transaction is the effective settlement of a pre-existing relationship, the method used to determine the settlement amount.

(m) The disclosure of separately recognized transactions required by (l) shall include the amount of acquisition-related costs and, separately, the amount of those costs recognized as an expense and the line item or items in the statement of financial performance in which those expenses are recognized. The amount of any issue costs not recognized as an expense and how they were recognized shall also be disclosed.

(n) In an acquisition in which a loss is recognized in surplus or deficit (see paragraph 86):

   (i) The amount of the loss recognized in accordance with paragraph 86 and the line item in the statement of financial performance in which the loss is recognized; and

   (ii) A description of the reasons why the transaction resulted in a loss.

(o) In a bargain purchase (see paragraphs 88–90):

   (i) The amount of any gain recognized in accordance with paragraph 88 and the line item in the statement of financial performance in which the gain is recognized; and

   (ii) A description of the reasons why the transaction resulted in a gain.

(p) For each acquisition in which the acquirer holds less than 100 percent of the quantifiable ownership interests or equivalent in the acquired operation at the acquisition date:

   (i) The amount of the non-controlling interest in the acquired operation recognized at the acquisition date and the measurement basis for that amount; and

(ii) For each non-controlling interest in an acquired operation measured at fair value, the valuation technique(s) and significant inputs used to measure that value.

(q) In an acquisition achieved in stages:

(i) The acquisition-date fair value of the equity interest in the acquired operation held by the acquirer immediately before the acquisition date; and

(ii) The amount of any gain or loss recognized as a result of remeasuring to fair value the equity interest in the acquired operation held by the acquirer before the acquisition (see paragraph 100) and the line item in the statement of financial performance in which that gain or loss is recognized.

(r) The following information:

(i) The amounts of revenue and expense, and the surplus or deficit of the acquired operation since the acquisition date included in the consolidated statement of financial performance for the reporting period; and

(ii) The revenue and expense, and the surplus or deficit of the combined entity for the current reporting period as though the acquisition date for all acquisitions that occurred during the year had been as of the beginning of the annual reporting period.

If disclosure of any of the information required by this subparagraph is impracticable, the acquirer shall disclose that fact and explain why the disclosure is impracticable. This Standard uses the term 'impracticable' with the same meaning as in IPSAS 3.

121. For individually immaterial acquisitions occurring during the reporting period that are material collectively, the acquirer shall disclose in aggregate the information required by paragraph 120(e)–(r).

122. If the acquisition date of an acquisition is after the end of the reporting period but before the financial statements are authorized for issue, the acquirer shall disclose the information required by paragraph 120 unless the initial accounting for the acquisition is incomplete at the time the financial statements are authorized for issue. In that situation, the acquirer shall describe which disclosures could not be made and the reasons why they cannot be made.

123. **The acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognized in the current reporting period that relate to acquisitions that occurred in the period or previous reporting periods.**

124. To meet the objective in paragraph 123, the acquirer shall disclose the following information for each material acquisition or in the aggregate for individually immaterial acquisitions that are material collectively:

(a) If the initial accounting for an acquisition is incomplete (see paragraph 103) for particular assets, liabilities, non-controlling interests or items of consideration and the amounts recognized in the financial statements for the acquisition thus have been determined only provisionally:

(i) The reasons why the initial accounting for the acquisition is incomplete;

(ii) The assets, liabilities, quantifiable ownership interests (or equivalent) or items of consideration for which the initial accounting is incomplete; and

(iii) The nature and amount of any measurement period adjustments recognized during the reporting period in accordance with paragraph 107.

(b) For each reporting period after the acquisition date until the entity collects, sells or otherwise loses the right to a contingent consideration asset, or until the entity settles a contingent consideration liability or the liability is cancelled or expires:

(i) Any changes in the recognized amounts, including any differences arising upon settlement;

(ii) Any changes in the range of outcomes (undiscounted) and the reasons for those changes; and

(iii) The valuation techniques and key model inputs used to measure contingent consideration.

(c) For contingent liabilities recognized in an acquisition, the acquirer shall disclose the information required by paragraphs 97 and 98 of IPSAS 19 for each class of provision.

(d) A reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period showing separately:

(i) The gross amount and accumulated impairment losses at the beginning of the reporting period.

(ii) Additional goodwill recognized during the reporting period.

(iii) Adjustments resulting from the subsequent recognition of amounts during the reporting period in accordance with the relevant international or national accounting standard dealing with income taxes.

(iv) Goodwill derecognized during the reporting period.

(v) Impairment losses recognized during the reporting period in accordance with IPSAS 26, *Impairment of Cash-Generating Assets*. (IPSAS 26 requires disclosure of information about the recoverable amount and impairment of goodwill in addition to this requirement.)

(vi) Net exchange rate differences arising during the reporting period in accordance with IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*.

(vii) Any other changes in the carrying amount during the reporting period.

(viii) The gross amount and accumulated impairment losses at the end of the reporting period.

(e) The amount and an explanation of any gain or loss recognized in the current reporting period that both:

(i) Relates to the identifiable assets acquired or liabilities assumed in an acquisition that was effected in the current or previous reporting period; and

(ii) Is of such a size, nature or incidence that disclosure is relevant to understanding the combined entity's financial statements.

And

(f) If amounts of tax due are forgiven as a result of the terms of the acquisition (see paragraphs 78–79):

(i) The amount of tax due that was forgiven; and

(ii) Where the acquirer is the tax authority, details of the adjustment made to tax receivable.

125. If the specific disclosures required by this and other IPSASs do not meet the objectives set out in paragraphs 119 and 123, the acquirer shall disclose whatever additional information is necessary to meet those objectives.

Effective Date and Transition

Effective Date

126. **This Standard shall be applied prospectively to public sector combinations for which the amalgamation date or acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2019. Earlier application is encouraged. If an entity applies this Standard before January 1, 2019, it shall disclose that fact.**

126A. **Paragraphs 25, 45, 70, 111, 115, 117 and AG88 were amended by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply IPSAS 41 at the same time.**

126B. **Paragraph 100A was added by *Improvements to IPSAS, 2018*, issued in October 2018. An entity shall apply this amendment to public sector combinations for which the acquisition date is on or after the beginning of the first annual financial statements covering periods beginning on or after January 1, 2019. Earlier application is permitted. If an entity applies this amendment for a period beginning before January 1, 2019, it shall disclose that fact.**

126C. When an entity adopts the accrual basis IPSASs as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)*, for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

126D. **Paragraph 126C was amended by *Improvements to IPSAS, 2019*, issued in January 2020. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2021. Earlier application is permitted.**

126E. **Paragraphs 68, 71, 120, AG76 and AG89 were amended, paragraphs AG72–AG74 and their related heading were deleted, and paragraphs 82A and 82B and the related heading were added by IPSAS 43 issued in January 2022. An**

entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

Transition

127. Assets and liabilities that arose from public sector combinations whose acquisition dates or amalgamation dates preceded the application of this Standard shall not be adjusted upon application of this Standard.

128. Contingent consideration balances arising from acquisitions whose acquisition dates preceded the date when an entity first applied this Standard shall not be adjusted upon first application of this Standard. Paragraphs 129–132 shall be applied in the subsequent accounting for those balances. Paragraphs 129–132 shall not apply to the accounting for contingent consideration balances arising from acquisitions with acquisition dates on or after the date when the entity first applied this Standard. In paragraphs 129–132 acquisitions refers exclusively to acquisitions whose acquisition date preceded the application of this Standard.

129. If an acquisition agreement provides for an adjustment to the cost of the acquisition contingent on future events, the acquirer shall include the amount of that adjustment in the cost of the acquisition at the acquisition date if the adjustment is probable and can be measured reliably.

130. An acquisition agreement may allow for adjustments to the cost of the acquisition that are contingent on one or more future events. The adjustment might, for example, be contingent on a specified level of profit being maintained or achieved in future periods, or on the market price of the instruments issued being maintained. It is usually possible to estimate the amount of any such adjustment at the time of initially accounting for the acquisition without impairing the reliability of the information, even though some uncertainty exists. If the future events do not occur or the estimate needs to be revised, the cost of the acquisition shall be adjusted accordingly.

131. However, when an acquisition agreement provides for such an adjustment, that adjustment is not included in the cost of the acquisition at the time of initially accounting for the acquisition if it either is not probable or cannot be measured reliably. If that adjustment subsequently becomes probable and can be measured reliably, the additional consideration shall be treated as an adjustment to the cost of the acquisition.

132. In some circumstances, the acquirer may be required to make a subsequent payment to the seller as compensation for a reduction in the value of the assets given, equity instruments issued or liabilities incurred or assumed by the acquirer in exchange for control of the acquired operation. This is the case, for example, when the acquirer guarantees the market price of equity or debt instruments issued as part of the cost of the acquisition and is required to issue additional equity or debt instruments to restore the originally determined cost. In such cases, no increase in the cost of the acquisition is recognized. In the case of equity instruments, the fair value of the additional payment is offset by an equal reduction in the value attributed to the instruments initially issued. In the case of debt instruments, the additional payment is regarded as a reduction in the premium or an increase in the discount on the initial issue.

133. An entity, such as a mutual entity, that has not yet applied this Standard and had one or more public sector combinations that were accounted for using the purchase method (which involves the amortization of goodwill) shall apply the transition provisions in paragraphs AG114–AG115.

Income taxes

134. For public sector combinations in which the acquisition date or amalgamation date was before this Standard is applied, the acquirer or resulting entity shall apply the requirements of the relevant international or national accounting standard dealing with income taxes prospectively. From the date when this Standard is applied, the acquirer or resulting entity shall recognize any changes required by the relevant international or national accounting standard dealing with income taxes as an adjustment to surplus or deficit (or, if required by the relevant international or national accounting standard dealing with income taxes, outside surplus or deficit).

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 40.

Definitions (see paragraph 5)

AG1. Paragraph 5 of this Standard defines a resulting entity as "the entity that is the result of two or more operations combining in an amalgamation." A resulting entity is not initially a party to the public sector combination. A resulting entity may have the legal form of a new entity, or may retain the legal identity of one of the combining operations. However, a resulting entity usually has the economic substance of a new entity. In a combination in which one party to the combination gains control of one or more operations, and in which the economic substance is that of an amalgamation, the nature of the combination is usually that the resulting entity has the substance of a new entity.

Identifying a Public Sector Combination (see paragraph 6)

AG2. Paragraph 5 of this Standard defines a public sector combination as "the bringing together of separate operations into one public sector entity." The reference to one public sector entity may be to a single entity or to an economic entity. Some public sector reorganizations may involve more than one public sector combination. The circumstances in which a public sector combination might occur include:

(a) By mutual agreement; and

(b) By compulsion (for example by legislation).

AG3. Paragraph 5 of this Standard defines an operation as "an integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving an entity's objectives, by providing goods and/or services."

AG4. An operation consists of inputs and processes applied to those inputs that have the ability to create outputs. Although operations usually have outputs, outputs are not required for an integrated set of activities and related assets and/or liabilities to qualify as an operation. For the purposes of this standard, the three elements of an operation are defined as follows:

(a) **Input**: Any economic resource that creates, or has the ability to create, outputs when one or more processes are applied to it.

(b) **Process**: Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs.

(c) **Output**: The result of inputs and processes applied to those inputs that provide, or have the ability to provide, goods and/or services.

The definitions of an input and an output differ from those in RPG 3, *Reporting Service Performance Information*. This is because RPG 3 focuses on recipients who are external to the entity; an operation may have recipients who are internal to an entity.

AG5. To be capable of being conducted and managed for the purposes defined, an integrated set of activities and assets and/or liabilities requires two essential elements—inputs and processes applied to those inputs, which together are or will be used to create outputs. However, an operation need not include all of the inputs or processes that the transferor used in operating that operation if the entity that receives the operation or operations is capable of continuing to produce outputs, for example, by integrating the operation with their own inputs and processes.

AG6. The nature of the elements of an operation varies by sector and by the structure of an entity's operations (activities), including the entity's stage of development. Established operations often have many different types of inputs, processes and outputs, whereas new operations often have few inputs and processes and sometimes only a single output (product). Nearly all operations also have liabilities, but an operation need not have liabilities.

AG7. An integrated set of activities and assets and/or liabilities in the development stage might not have outputs. In these cases, the entity that receives the operation should consider other factors to determine whether the set is an operation. Those factors include, but are not limited to, whether the set:

(a) Has begun planned principal activities;

(b) Has employees, intellectual property and other inputs and processes that could be applied to those inputs;

(c) Is pursuing a plan to produce outputs; and

(d) Will be able to obtain access to service recipients that will receive the outputs.

Not all of those factors need to be present for a particular integrated set of activities and assets and/or liabilities in the development stage to qualify as an operation.

AG8. Determining whether a particular set of activities and assets and/or liabilities is an operation should be based on whether the integrated set is capable of being conducted and managed as an operation by another entity. Thus, in evaluating whether a particular set is an operation, it is not relevant whether a transferor operated the set as an operation or whether the acquirer intends to operate the set as an operation.

AG9. In the absence of evidence to the contrary, a particular set of activities and assets and/or liabilities in which goodwill is present shall be presumed to be an operation. However, an operation need not have goodwill.

Classification of Public Sector Combinations (see paragraphs 7–14)

Assessment of Control (see paragraphs 7–8)

AG10. Where a party to a public sector combination gains control of one or more operations as a result of that combination, the combination is classified as either an amalgamation or an acquisition, depending on the economic substance of the combination. If no party to the combination gains control, the combination is classified as an amalgamation. In making this assessment the first step is to determine whether one of the entities that existed prior to the public sector combination has gained control of one or more operations. Because this determination is made by reference to the entities that existed prior to the public sector combination, it differs from the assessment of control made in accordance with IPSAS 35, *Consolidated Financial Statements*, where the assessment of control is made by reference to the entities that exist after a public sector combination has taken place.

AG11. In determining whether one party to a public sector combination gains control of one or more operations as a result of the combination, an entity applies the principles and guidance in IPSAS 35. In applying the principles and guidance, references to "an entity controls" are read as "an entity gains control of" and references to "another entity" are read as "an operation". For example, in determining whether one party to a public sector combination gains control of one or more operations as a result of the combination for the purposes of this Standard, paragraph 20 of IPSAS 35 should be read as follows (amended text is shown in italics):

> Thus, an entity *gains control of an operation* if and only if the entity *gains* all the following:
>
> (a) Power over the operation (see paragraphs 23–29);
>
> (b) Exposure, or rights, to variable benefits from its involvement with the operation (see paragraphs 30–34); and
>
> (c) The ability to use its power over the operation to affect the nature or amount of the benefits from its involvement with the operation (see paragraphs 35–37).

AG12. In applying the principles and guidance in IPSAS 35, an entity has regard to paragraphs AG13–AG18.

AG13. A public sector combination effected primarily by the transfer of consideration (i.e., by transferring cash or other assets or by incurring liabilities) usually results in one entity gaining control of one or more operations.

AG14. A public sector combination effected primarily by exchanging equity interests usually results in one entity gaining control of one or more operations. Combinations involving an exchange of equity interests usually results in one entity having sufficient voting rights to gain control of one or more operations. This may occur without the entity having a majority of the voting rights where the entity has a large minority voting interest and no other owner or organized group of owners has a significant voting interest.

AG15. A public sector combination involving the issuance of equity interests may give rise to a reverse acquisition (see paragraphs AG66–AG71). An entity considers this possibility in determining whether one party to a public sector combination gains control of operations.

AG16. In a public sector combination involving more than two entities, the party to the public sector combination that initiates the combination (if any) is more likely to gain control of operations than the other parties to the combination.

AG17. In a public sector combination in which a new entity is formed to effect the combination, that entity may gain control of operations only where the entity exists prior to the combination taking place. Where this new entity does not exist prior to the combination taking place, an entity considers whether one of the parties to the combination that existed prior to the combination taking place gains control of operations.

AG18. If the application of this guidance identifies one party to the combination as gaining control of one or more operations, the combination is classified as either an amalgamation or an acquisition, depending on the economic substance of the combination. An entity considers the guidance in paragraphs 9–14 and AG19–AG50 to determine whether the economic substance of the combination is that of an amalgamation. If the application of the guidance does not identify one party to the combination as gaining control of one or more operations, the combination shall be classified as an amalgamation.

Assessment of the Classification of a Public Sector Combination (see paragraphs 9–14)

AG19. If one party to a public sector combination gains control of one or more operations as a result of the combination, the combination shall be classified as either an amalgamation or an acquisition, depending on the economic substance of the combination. In assessing whether the economic substance of the combination is that of an amalgamation, an entity considers the economic substance of the public sector combination and the indicators in paragraphs 12–14. A combination that does not have the economic substance of an amalgamation shall be classified as an acquisition. In making this assessment, an entity considers the following guidance.

Economic Substance (see paragraph 9)

AG20. Usually, an analysis of the indicators in paragraphs 12–13, individually or on combination, will produce a conclusive result and provide sufficient evidence to determine whether the economic substance of the combination is that of an amalgamation. A combination does not need to satisfy both of these indicators to be classified as an amalgamation.

AG21. Where consideration of the indicators in paragraphs 12–13 produces inconclusive results or does not provide sufficient evidence to clearly determine the economic substance of the combination, an entity considers the additional matters in paragraph 14.

AG22. The economic substance of an amalgamation is usually that a new entity is formed, irrespective of the legal form of the resulting entity. This applies equally to a combination in which one party to the combination gains control of one or more operations. If the economic substance of a public sector combination is that one of the parties to the combination continues to exist, this may provide evidence that the economic substance of the combination is that of an acquisition. In combinations of operations under common control, the fact that the ultimate controlling entity controls the operations both before and after the combination reduces the significance of this factor.

AG23. An amalgamation involves the integration of the operations that are part of the public sector combination. In other words, an amalgamation does not give rise to a controlling entity/controlled entity relationship between parties to a combination. If, following the combination, any of the operations operate as controlled entities of a party to the combination, this may provide evidence that the economic substance of the combination is that of an acquisition.

AG24. An acquisition is usually a mutual agreement between two or more parties, and usually has commercial substance. However, in the public sector, a party to the combination may be able to impose a public sector combination on the other party to the combination. Where this results in the entity gaining access to economic benefits or service potential that are similar to those that could have been obtained by mutual agreement, it is probable that the economic substance of the public sector combination is that of an acquisition. For example, a central government may centralize a service for which it had been providing funding, by requiring local government entities to transfer operations to the central government in order to achieve economies of scale. Where the entity does not gain access to economic benefits or service potential that are similar to those that could have been obtained in a voluntary transaction, it is probable that the economic substance of the public sector combination is that of an amalgamation.

AG25. Where, after consideration of the indicators and the nature of the public sector combination, there is insufficient evidence that the public sector combination has the economic substance of an amalgamation, the combination shall be classified as an acquisition.

Indicators Relating to Consideration (see paragraph 12)

AG26. Amalgamations usually do not involve the payment of consideration to compensate a seller for giving up their entitlement to the net assets of an operation. By contrast, acquisitions usually involve an exchange of consideration between those gaining control of the operations and those losing control of the operations.

AG27. The payment of consideration that is intended to compensate those with an entitlement to the net assets of the transferred operation for giving up that entitlement provides evidence that the economic substance of the public sector combination is an acquisition. In such cases, the combination is classified as an acquisition.

AG28. The payment of consideration that is not intended to compensate the seller for giving up their entitlement to the net assets of an operation, but is, for example, intended to reimburse them for costs incurred in effecting the public sector combination, may provide evidence that the economic substance of the combination is that of an amalgamation.

AG29. Acquisitions may occur without an exchange of consideration, for example where an individual bequeaths an operation to a government entity. Consequently, the absence of consideration does not in itself provide evidence of the economic substance of the public sector combination. In assessing consideration, an entity also considers the reasons why consideration was either paid or not paid.

AG30. Where a public sector combination does not include the payment of consideration, an entity considers the reasons why no consideration has been paid. If the former owner has given up their entitlement to the net assets of an operation, or has had their entitlement extinguished through compulsion (for example, in an uncompensated seizure), there may be evidence that the combination is an acquisition.

AG31. Where a public sector combination does not include the payment of consideration because there is no party with an entitlement to the net assets of an operation, the economic substance of the combination will usually be that of an amalgamation. An acquisition involves a transfer of an operation from its former owner to its new owner. If there is no party with an entitlement to the net assets of an operation, there is no former owner, and the combination is usually not an acquisition. This scenario will only arise where a complete entity is being transferred; where an individual operation is being transferred, the entity transferring the operation will be the former owner and will be entitled to the net assets of the operation. Examples of entities where there will be no former owner(s) include municipalities and some not-for-profit organizations.

Indicators Relating to the Decision-Making Process (see paragraph 13)

AG32. An acquisition usually requires the voluntary participation of all the parties to the combination. Consequently, where a public sector combination is imposed by a third party without any party to the combination being involved in the decision-making process, this may provide evidence that the economic substance of the combination is an amalgamation.

AG33. In other circumstances, the parties to the public sector combination will be able to influence the terms of the combination to different degrees even when the combination is imposed by a third party. As the degree of influence the parties to the combination have increases, particularly the influence of the party that gains control of one or more operations, it becomes less likely that a conclusion regarding the economic substance of the combination can be drawn.

AG34. For example, the parties to the combination may be directed to combine by a regulator, but the regulator allows the parties to determine the terms of the combination. The economic substance of this public sector combination is likely to be determined by the terms of the combination agreed by the parties rather than by the decision of the regulator that the parties must combine.

AG35. Where the party to the public sector combination that gains control of one or more operations is able to impose the combination on the other party, this does not provide evidence that the economic substance of the combination is that of an amalgamation. For example, a government may decide to nationalize a private sector entity, contrary to the wishes of the shareholders. The fact that the government (a party to the combination) is able to impose the nationalization, for example through legislation, does not provide evidence that the economic substance of the combination is an amalgamation. Where the party to the combination that gains control of one or more operations is able to impose the combination on the other party, this provides evidence that the economic substance of the combination is that of an acquisition.

AG36. Where a public sector combination is subject to approval by each party's citizens through referenda, this may provide evidence that the economic substance of the combination is that of an amalgamation. Such a requirement provides evidence that the parties to the combination do not have freedom to voluntarily effect the combination and that the ultimate decision as to whether the combination takes place is taken by third parties. However, it is possible for citizens to approve, through referenda, a combination whose terms are those of an acquisition.

AG37. Where a public sector combination takes place between two parties that are under common control, this may provide evidence that the economic substance of the combination is that of an amalgamation. Public sector combinations under common control are often instigated by and on behalf of the controlling entity, and the controlling entity will often determine the terms of the combination. For example, a government may decide to combine two ministries for administrative or political reasons, and specify the terms of the combination. In such circumstances, the ultimate decision as to whether the combination takes place, and the terms of the combination, are determined by the controlling entity. This provides evidence that the economic substance of the combination is an amalgamation.

AG38. In some circumstances, two operations under common control may agree to combine voluntarily. However, this decision will usually be subject to the approval of the controlling entity, whether this approval is given explicitly or not. Where the approval of the controlling entity is required, this provides evidence that the ultimate decision as to whether the combination takes place, and the terms of the combination, are determined by the controlling entity. Consequently, this provides evidence that the economic substance of the combination is that of an amalgamation.

AG39. Only where there is no evidence that the controlling entity is involved in the public sector combination, either by instigating the combination, determining the terms of the combination, or approving (whether explicitly or implicitly) the combination, will there be no evidence that the economic substance of the combination is that of an amalgamation. In such circumstances, the entity considers all other factors in determining the classification of the public sector combination.

Additional Matters to be Considered Where the Indicators Relating to Consideration and the Decision-Making Process do not Provide Sufficient Evidence to Determine Whether the Economic Substance of the Combination is that of an Amalgamation (see paragraph 14)

AG40. Where an analysis of the indicators relating to consideration and the decision-making process produces inconclusive results or does not provide sufficient evidence to determine whether the economic substance of the combination is that of an amalgamation, an entity considers which classification and resulting accounting treatment would provide information that:

(a) Best meets the objectives of financial reporting; and

(b) Best satisfies the qualitative characteristics (QCs).

AG41. An analysis of the indicators relating to consideration and the decision-making process will usually produce a conclusive result and provide sufficient evidence to determine whether the economic substance of the combination is that of an amalgamation. This is because the indicators relating to consideration and the decision-making process will provide evidence of the economic substance of a public sector combination in all but exceptional circumstances. As a result, where it is clear that the indicators have been met, the additional matters set out in paragraph 14 are not considered in determining the classification.

AG42. Where an analysis of the indicators relating to consideration and the decision-making process provides inconclusive results or does not provide sufficient evidence to determine whether the economic substance of the combination is that of an amalgamation, an entity considers which classification would provide information that best meets the objectives of financial reporting. The determination of whether a public sector combination is classified as an acquisition or an amalgamation can significantly affect the financial reporting of the combination. Consequently, it is important to consider the information each method provides and the principal users of that information.

AG43. The modified pooling of interests method views the combination from the perspective of each of the combining operations and their owners or constituents who are uniting their interests in the resulting entity. Using the modified pooling of interests method of accounting, the combining operations measure the reported assets and liabilities at their carrying amounts in the financial statements of the combining operations as of the amalgamation date. Such information may assist users in assessing the performance of the resulting entity based upon the combined historical assets and liabilities of the combining operations at the date of the amalgamation and in comparing operating results with prior periods. However, this comparability may be reduced where adjustments to achieve consistent accounting policies are required. It does not include information about the market's expectation of the value of the future cash flows associated with assets and liabilities, other than assets and liabilities recorded at fair value prior to the date of the amalgamation.

AG44. The acquisition method views a combination from the perspective of the acquirer—the entity that gains control of the other operations. The acquirer purchases or otherwise gains control over net assets and recognizes in its financial statements the assets acquired and liabilities assumed, including those not previously recognized by the acquired operation. Such information assists users of the financial statements in assessing the initial investments made and the subsequent performance of those investments and comparing them with the performance of other entities based on the investment made by the acquirer. It also includes information about the market's expectation of the value of the future cash flows associated with those assets and liabilities. While it revalues the assets and liabilities of the acquired operation, it does not affect the valuation of assets and liabilities held by the acquirer prior to the acquisition. Further, depending on the relationship between the amounts in paragraph 85(a) and 85(b) and other factors (for example, a bargain purchase), it may result in the immediate recognition of a gain or loss through surplus or deficit.

AG45. The information provided by each approach is summarized in the following table.

	Amalgamation	Acquisition
Perspective	Perspective of each of the combining operations and their owners or constituents.	Perspective of the acquirer.
User information	Assists users of the financial statements in assessing the performance of the resulting entity based upon the combined historical assets and liabilities of the combining operations at the date of the amalgamation and in comparing operating results with prior periods.	Assists users of the financial statements in assessing the initial investments made and the subsequent performance of those investments.
Basis of reported values	Measures the reported assets and liabilities at their carrying amounts in the financial statements of the combining operations as of the amalgamation date.	Revalues the identifiable assets and liabilities of the acquired operation but does not affect the valuation of assets and liabilities held by the acquirer. Includes information about the market's expectation of the value of the future cash flows associated with those assets and liabilities.
Ability to compare to operating results of prior periods	May facilitate the comparison of operating results with prior periods. Comparability may be reduced where adjustments to achieve consistent accounting policies are required.	Difficult to compare operating results with prior periods.

AG46. Consideration of which classification would provide information that best meets the objectives of financial reporting provides evidence of the economic substance of the public sector combination where an analysis of the indicators relating to consideration and the decision-making process provides inconclusive results or does not provide sufficient evidence to determine whether the economic substance of the combination is that of an amalgamation.

AG47. Where an analysis of the indicators relating to consideration and the decision-making process provides inconclusive results or does not provide sufficient evidence to determine the classification of the combination, an entity considers which classification would provide information that best satisfies the QCs of relevance, faithful representation, understandability, timeliness, comparability and verifiability. In making this assessment, an entity also considers the constraints on information included in general purpose financial reports, which are materiality, cost-benefit and the balance between the QCs.

AG48. When considering the classification of a public sector combination, some QCs will be more significant than others. For example, timeliness will be less significant than understandability when considering whether a combination is an amalgamation or an acquisition.

AG49. An entity considers the QCs and the constraints on information from the perspective of the users of the financial statements. This will include consideration of the following questions; this list is not exhaustive.

(a) Which classification most faithfully represents the economic substance of the public sector combination, which may be different from its legal form? Does that classification faithfully represent an entity's financial performance and financial position?

(b) Which classification will help users understand the nature of the public sector combination? For example, in an amalgamation, any difference between the total recognized assets and total recognized liabilities is recognized in net assets/equity, whereas in an acquisition, the acquirer recognizes goodwill, or a gain or loss in the reporting period. Which approach best helps the user to understand the nature of the combination?

(c) Users' needs are best served when the information provided in respect of a transaction is comparable. How are similar public sector combinations classified?

AG50. Consideration of which classification would provide information that best meets the QCs provides evidence of the economic substance of the public sector combination where an analysis of the indicators relating to consideration and the decision-making process provides inconclusive results or does not provide sufficient evidence to determine whether the economic substance of the combination is that of an amalgamation.

Accounting for Amalgamations

Eliminating Transactions Between the Combining Operations (see paragraph 22)

AG51. A resulting entity eliminates the effects of all transactions between the combining operations. For many transactions, elimination will take place automatically. For example, one combining operation provided services for a fee to another combining operation prior to the amalgamation date. The revenue of the combining operation that provided the services is reflected in that combining operation's accumulated surplus or deficit at the amalgamation date. The expense of the combining operation receiving the services is reflected in that combining operation's accumulated surplus or deficit at the amalgamation date. The resulting entity will recognize both amounts in net assets/equity.

AG52. Elimination may not take place automatically where one combining operation has recognized an asset, and another combining operation has recognized a corresponding liability as a result of the transaction between two combining operations. The resulting entity eliminates both the asset and the liability, and recognizes any difference between the asset and liability in net assets/equity.

Carrying Amounts to be Used (see paragraphs 26–27)

AG53. Where a combining operation has previously been acquired in an acquisition (i.e., it was previously an acquired operation), the carrying amounts of the combining operation's assets and liabilities in its separate financial statements may be different to the carrying amounts of those assets and liabilities in the controlling entity's financial statements. In an acquisition, the controlling entity would measure the combining operation's assets and liabilities at their fair value. However, where the combining operation (i.e., the previously acquired operation) continues to prepare separate financial statements, it would use its previous carrying amounts. The fair value measurements in the financial statements of the controlling entity are not pushed down to the combining operation.

AG54. To meet the requirements in paragraphs 26–27, a resulting entity measures the identifiable assets and liabilities of the combining operations at their carrying amounts in the financial statements of the combining operations as of the amalgamation date, subject to the requirement to adjust the carrying amounts to conform to the resulting entity's accounting policies. The resulting entity does not measure the assets and liabilities at the carrying amounts in the financial statements of the controlling entity.

Licenses and Similar Rights Previously Granted by One Combining Operation to Another Combining Operation (see paragraph 32)

AG55. As part of an amalgamation, a resulting entity may receive a license or similar right that had previously been granted by one combining operation to another combining operation to use one or more of the grantor's recognized or unrecognized assets. Examples of such rights include a right to use the acquirer's technology under a technology licensing agreement. The resulting entity recognizes this license or similar right as an identifiable intangible asset, and measures the intangible asset at its carrying amount in the financial statements of the combining operation as of the amalgamation date. Because the license or similar right has previously been part of a binding arrangement, the license satisfies both the separability and binding arrangement criteria in IPSAS 31, *Intangible Assets*. Paragraph 47 provides guidance on the subsequent accounting for a license or similar right previously granted by one combining operation to another combining operation.

AG56. The resulting entity assesses both the license or similar right previously granted by one combining operation to another combining operation, and the underlying asset (where the underlying asset is a recognized asset) for impairment in accordance with IPSAS 21, *Impairment of Non-Cash-Generating Assets* and IPSAS 26, *Impairment of Cash-Generating Assets*, at the amalgamation date.

Forgiveness of Amounts of Tax Due in an Amalgamation (Where Included in the Terms of the Amalgamation) (see paragraphs 33–34)

AG57. The resulting entity shall not recognize any amounts in respect of a combining operation's tax due where these amounts have been forgiven by a tax authority as part of the terms of the amalgamation. Where tax forgiveness occurs subsequent to an amalgamation, the resulting entity applies the requirements in paragraph 49. In applying the modified pooling of interests method of accounting, the resulting entity shall treat those amounts included in the terms of the amalgamation as having been derecognized prior to the amalgamation. The resulting entity shall account for a combining operation's tax due that has not been forgiven by a tax authority in accordance with the relevant international or national accounting standard dealing with income taxes.

AG58. Where, as a result of the amalgamation, the resulting entity becomes the tax authority, it shall derecognize any tax receivable relating to the combining operation's tax due that has been forgiven in accordance with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

Recognition of Goodwill (see paragraph 36)

AG59. Amalgamations do not give rise to goodwill, and consequently a resulting entity does not recognize goodwill arising from an amalgamation. Paragraphs 37–38 specify the treatment of the net assets/equity arising as a result of the amalgamation.

AG60. Where a combining operation has previously recognized goodwill as a result of a previous acquisition, the resulting entity recognizes this goodwill in its opening statement of financial position.

Subsequent Measurement of Transfers, Concessionary Loans and Similar Benefits Received by a Combining Operation on the Basis of Criteria that May Change as a Result of an Amalgamation (see paragraph 48)

AG61. Prior to an amalgamation taking place, a combining operation may receive a transfer from a third party, based on specified criteria. For example, a national government may provide grants to those municipalities where the average household income is below a threshold. An amalgamation of two municipalities may involve one municipality which met the criteria and received the grant, and one municipality which did not meet the criteria and which did not receive the grant. Following the amalgamation, the average household income of the new, combined municipality will either be above or below the threshold, which may cause the grantor to reassess the amount of grant given.

AG62. The resulting entity shall not account for any revisions to the grant amount as part of the amalgamation, but shall account for any revisions at the point the grantor makes its intentions known in accordance with other IPSASs.

AG63. Similar circumstances may arise in respect of concessionary loans and other benefits. The resulting entity shall not account for any revisions to those transactions as part of the amalgamation, but shall account for any revisions at the point the grantor makes its intentions known in accordance with other IPSASs.

Amalgamations Occurring during a Reporting Period (see paragraphs 50–52)

AG64. To meet the requirements of paragraphs 50–52, the resulting entity is not required to present financial statements for periods prior to the amalgamation date, although it may elect to do so by making the disclosures specified in paragraph 54(g). Where the resulting entity does not elect to present financial statements for periods prior to the amalgamation date, it meets the needs of the users of its financial statements for information about the combining operations prior to the amalgamation by:

(a) Where financial statements have been issued on behalf of the combining operations for a reporting period ending immediately prior to the amalgamation date (which may be a partial period), directing the users of its financial statements to the financial statements issued on behalf of the combining operations.

(b) Where no financial statements have been issued on behalf of the combining operations for a reporting period ending immediately prior to the amalgamation date (which may be a partial period), making the disclosures required by paragraph 54(h).

AG65. To satisfy the requirements of a regulator, it may be necessary for the combining operations and/or the resulting entity to present or disclose information in addition to that required by this Standard.

Accounting for Acquisitions

Reverse Acquisitions

AG66. A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquired operation for accounting purposes on the basis of the guidance in paragraphs AG10–AG18. The entity whose equity interests are acquired (the legal acquired operation) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. For example, reverse acquisitions sometimes occur when a public sector entity wants to become a listed entity but does not want to register its equity shares. To accomplish that, the public sector entity will arrange for a listed entity to acquire its equity interests in exchange for the equity interests of the listed entity. In this example, the listed entity is the legal acquirer because it issued its equity interests, and the public sector entity is the legal acquired operation because its equity interests were acquired. However, application of the guidance in paragraphs AG10–AG18 results in identifying:

(a) The listed entity as the acquired operation for accounting purposes (the accounting acquired operation)–i.e., the listed entity does not gain control of one or more operations; and

(b) The public sector entity as the acquirer for accounting purposes (the accounting acquirer)–i.e., the public sector entity does gain control of one or more operations.

The accounting acquired operation must meet the definition of an operation for the transaction to be accounted for as a reverse acquisition, and all of the recognition and measurement principles in this Standard, including the requirement to recognize goodwill, apply.

Measuring the Consideration Transferred

AG67. In a reverse acquisition, the accounting acquirer usually issues no consideration for the acquired operation. Instead, the accounting acquired operation usually issues its equity shares to the owners of the accounting acquirer. Accordingly, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquired operation is based on the number of equity interests the legal controlled entity would have had to issue to give the owners of the legal controlling entity the same percentage equity interest in the combined entity that results from the reverse acquisition. The fair value of the number of equity interests calculated in that way can be used as the fair value of consideration transferred in exchange for the acquired operation.

Preparation and Presentation of Consolidated Financial Statements

AG68. Consolidated financial statements prepared following a reverse acquisition are issued under the name of the legal controlling entity (accounting acquired operation) but described in the notes as a continuation of the financial statements of the legal controlled entity (accounting acquirer), with one adjustment, which is to adjust retroactively the accounting acquirer's legal capital to reflect the legal capital of the accounting acquired operation. That adjustment is required to reflect the capital of the legal controlling entity (the accounting acquired operation). Comparative information presented in those consolidated financial statements also is retroactively adjusted to reflect the legal capital of the legal controlling entity (accounting acquired operation).

AG69. Because the consolidated financial statements represent the continuation of the financial statements of the legal controlled entity except for its capital structure, the consolidated financial statements reflect:

(a) The assets and liabilities of the legal controlled entity (the accounting acquirer) recognized and measured at their pre-combination carrying amounts.

(b) The assets and liabilities of the legal controlling entity (the accounting acquired operation) recognized and measured in accordance with this Standard.

(c) The accumulated surplus or deficit and other equity balances of the legal controlled entity (accounting acquirer) before the acquisition.

(d) The amount recognized as issued equity interests in the consolidated financial statements determined by adding the issued equity interest of the legal controlled entity (the accounting acquirer) outstanding immediately before the acquisition to the fair value of the legal controlling entity (accounting acquired operation). However, the equity structure (i.e., the number and type of equity interests issued) reflects the equity structure of the legal controlling entity (the accounting acquired operation), including the equity interests the legal controlling entity issued to effect the acquisition. Accordingly, the equity structure of the legal controlled entity (the accounting acquirer) is restated using the exchange ratio established in the acquisition agreement to reflect the number of shares of the legal controlling entity (the accounting acquired operation) issued in the reverse acquisition.

(e) The non-controlling interest's proportionate share of the legal controlled entity's (accounting acquirer's) pre-acquisition carrying amounts of retained earnings and other equity interests as discussed in paragraphs AG70 and AG71.

Non-Controlling Interest

AG70. In a reverse acquisition, some of the owners of the legal acquired operation (the accounting acquirer) might not exchange their equity interests for equity interests of the legal controlling entity (the accounting acquired operation). Those owners are treated as a non-controlling interest in the consolidated financial statements after the reverse acquisition. That is because the owners of the legal acquired operation that do not exchange their equity interests for equity interests of the legal acquirer have an interest in only the results and net assets of the legal acquired operation—not in the results and net assets of the combined entity. Conversely, even though the legal acquirer is the acquired operation for accounting purposes, the owners of the legal acquirer have an interest in the results and net assets of the combined entity.

AG71. The assets and liabilities of the legal acquired operation are measured and recognized in the consolidated financial statements at their pre-combination carrying amounts (see paragraph AG69(a)). Therefore, in a reverse acquisition the non-controlling interest reflects the non-controlling shareholders' proportionate interest in the pre-acquisition carrying amounts of the legal acquired operation's net assets even if the non-controlling interests in other acquisitions are measured at their fair value at the acquisition date.

Recognizing Particular Assets Acquired and Liabilities Assumed in an Acquisition (see paragraphs 64–68)

AG72. [Deleted]

AG73. [Deleted]

AG74. [Deleted]

Intangible Assets

AG75. The acquirer shall recognize, separately from goodwill, the identifiable intangible assets acquired in an acquisition. An intangible asset is identifiable if it meets either the separability criterion or the binding arrangement criterion.

AG76. An intangible asset that meets the binding arrangement criterion is identifiable even if the asset is not transferable or separable from the acquired operation or from other rights and obligations. For example:

(a) [Deleted]

(b) An acquired operation owns and operates a nuclear power plant. The license to operate that power plant is an intangible asset that meets the binding arrangement criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. An acquirer may recognize the fair value of the operating license and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.

(c) An acquired operation owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future foreign revenue in exchange. Both the technology patent and the related license agreement meet the binding arrangement criterion for recognition separately from goodwill even if selling or exchanging the patent and the related license agreement separately from one another would not be practical.

AG77. The separability criterion means that an acquired intangible asset is capable of being separated or divided from the acquired operation and sold, transferred, licensed, rented or exchanged, either individually or together with a related binding arrangement, identifiable asset or liability. An intangible asset that the acquirer would be able to sell, license or otherwise exchange for something else of value meets the separability criterion even if the acquirer does not intend to sell, license or otherwise exchange it. An acquired intangible asset meets the separability criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type, even if those transactions are infrequent and regardless of whether the acquirer is involved in them. For example, lists of users of a service are frequently licensed and thus meet the separability criterion. Even if an acquired operation believes its lists of users of a service have characteristics different from other lists of users of a service, the fact that lists of users of a service are frequently licensed generally means that the acquired list of users of a service meets the separability criterion. However, a list of users of a service acquired in an acquisition would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing or otherwise exchanging information about its users of a service.

AG78. An intangible asset that is not individually separable from the acquired operation or combined entity meets the separability criterion if it is separable in combination with a related binding arrangement, identifiable asset or liability. For example, an acquired operation owns a registered trademark and documented but unpatented technical expertise used to manufacture the trademarked product. To transfer ownership of a trademark, the owner is also required to transfer everything else necessary for the new owner to produce a product or service indistinguishable from that produced by the former owner. Because the unpatented technical expertise must be separated from the acquired operation or combined entity and sold if the related trademark is sold, it meets the separability criterion.

Reacquired Rights

AG79. As part of an acquisition, an acquirer may reacquire a right that it had previously granted to the acquired operation to use one or more of the acquirer's recognized or unrecognized assets. Examples of such rights include a right to use the acquirer's technology under a technology licensing agreement. A reacquired right is an identifiable intangible asset that the acquirer recognizes separately from goodwill or a gain from a bargain purchase. Paragraph 83 provides guidance on measuring a reacquired right and paragraph 113 provides guidance on the subsequent accounting for a reacquired right.

AG80. If the terms of the binding arrangement giving rise to a reacquired right are favorable or unfavorable relative to the terms of current market transactions for the same or similar items, the acquirer shall recognize a settlement gain or loss. Paragraph AG100 provides guidance for measuring that settlement gain or loss.

Assembled Workforce and Other Items that are not Identifiable

AG81. The acquirer subsumes into goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date. For example, an acquirer may attribute value to the existence of an assembled workforce, which is an existing collection of employees that permits the acquirer to continue to operate an acquired operation from the acquisition date. An assembled workforce does not represent the intellectual capital of the skilled workforce—the (often specialized) knowledge and experience that employees of an acquired operation bring to their jobs. Because the assembled workforce is not an identifiable asset to be recognized separately from goodwill or a gain from a bargain purchase, any value attributed to it is subsumed into goodwill or a gain from a bargain purchase.

AG82. The acquirer also subsumes into goodwill or a gain from a bargain purchase any value attributed to items that do not qualify as assets at the acquisition date. For example, the acquirer might attribute value to potential binding arrangements the acquired operation is negotiating with prospective new customers at the acquisition date. Because those potential binding arrangements are not themselves assets at the acquisition date, the acquirer does not recognize them separately from goodwill or a gain from a bargain purchase. The acquirer should not subsequently reclassify the value of those binding arrangements from goodwill for events that occur after the acquisition date. However, the acquirer should assess the facts and circumstances surrounding events occurring shortly after the acquisition to determine whether a separately recognizable intangible asset existed at the acquisition date.

AG83. After initial recognition, an acquirer accounts for intangible assets acquired in an acquisition in accordance with the provisions of IPSAS 31. However, as described in paragraph 6 of IPSAS 31, the accounting for some acquired intangible assets after initial recognition is prescribed by other IPSASs.

AG84. The identifiability criteria determine whether an intangible asset is recognized separately from goodwill. However, the criteria neither provide guidance for measuring the fair value of an intangible asset nor restrict the assumptions used in measuring the fair value of an intangible asset. For example, the acquirer would take into account the assumptions that market participants would use when pricing the intangible asset, such as expectations of future renewals of binding arrangements, in measuring fair value. It is not necessary for the renewals themselves to meet the identifiability criteria. (However, see paragraph 83, which establishes an exception to the fair value measurement principle for reacquired rights recognized in an acquisition.) Paragraphs 39D and 39E of IPSAS 31 provide guidance for determining whether intangible assets should be combined into a single unit of account with other intangible or tangible assets.

Forgiveness of Amounts of Tax Due in an Acquisition (Where Included in the Terms of the Acquisition) (see paragraphs 78–79)

AG85. The acquirer shall not recognize any amounts in respect of an acquired operation's tax due where these amounts have been forgiven by a tax authority as part of the terms of the acquisition. Where tax forgiveness occurs subsequent to an acquisition, the resulting entity applies the requirements in paragraph 118. The acquirer shall account for an acquired operation's tax due that has not been forgiven by a tax authority in accordance with the relevant international or national accounting standard dealing with income taxes.

AG86. If the acquirer is itself the tax authority, it shall derecognize any tax receivable relating to the acquired operation's tax due that has been forgiven in accordance with IPSAS 23.

AG87. If, as a consequence of the terms of an acquisition, a tax authority forgives an amount of the acquirer's tax due, the acquirer shall derecognize those amounts in accordance with the relevant international or national accounting standard dealing with income taxes.

Measuring the Fair Value of Particular Identifiable Assets and a Non-Controlling Interest in an Acquired Operation in an Acquisition (see paragraphs 72–73)

Assets with Uncertain Cash Flows (Valuation Allowances)

AG88. The acquirer shall not recognize a separate valuation allowance as of the acquisition date for assets acquired in an acquisition that are measured at their acquisition-date fair values because the effects of uncertainty about future cash flows are included in the fair value measure. For example, because this Standard requires the acquirer to measure acquired receivables, including loans, at their acquisition-date fair values in accounting for an acquisition, the acquirer does not recognize a separate valuation allowance for the cash flows of the binding arrangement that are deemed to be uncollectible at that date or a loss allowance for expected credit losses.

Assets Subject to Operating Leases in Which the Acquired Operation is the Lessor

AG89. In measuring the acquisition-date fair value of an asset such as a building that is subject to an operating lease in which the acquired operation is the lessor, the acquirer shall take into account the terms of the lease. The acquirer does not recognize a separate asset or liability if the terms of an operating lease are either favorable or unfavorable when compared with market terms.

Assets that the Acquirer Intends not to Use or to Use in a Way that is Different from the Way Other Market Participants Would Use them

AG90. To protect its competitive position, or for security or other reasons, the acquirer may intend not to use an acquired non-financial asset actively, or it may not intend to use the asset according to its highest and best use. For example, that might be the case for an acquired research and development intangible asset that the acquirer plans to use defensively by preventing others from using it. Nevertheless, the acquirer shall measure the fair value of the non-financial asset assuming its highest and best use by market participants in accordance with the appropriate valuation premise, both initially and when measuring fair value less costs of disposal for subsequent impairment testing.

Non-Controlling Interest in an Acquired Operation

AG91. This Standard allows the acquirer to measure a non-controlling interest in the acquired operation at its fair value at the acquisition date. Sometimes an acquirer will be able to measure the acquisition-date fair value of a non-controlling interest on the basis of a quoted price in an active market for the equity shares (i.e., those not held by the acquirer). In other situations, however, a quoted price in an active market for the equity shares will not be available. In those situations, the acquirer would measure the fair value of the non-controlling interest using other valuation techniques.

AG92. The fair values of the acquirer's interest in the acquired operation and the non-controlling interest on a per-share basis might differ. The main difference is likely to be the inclusion of a control premium in the per-share fair value of the acquirer's interest in the acquired operation or, conversely, the inclusion of a discount for lack of control (also referred to as a non-controlling interest discount) in the per-share fair value of the non-controlling interest if market participants would take into account such a premium or discount when pricing the non-controlling interest.

Measuring Goodwill or a Gain from a Bargain Purchase in an Acquisition (see paragraphs 85–98)

Relationship Between Goodwill and Cash Flows (see paragraph 86)

AG93. The acquirer shall recognize goodwill only to the extent that the acquirer estimates there will be favorable changes to its net cash flows, either from increased cash inflows or decreased cash outflows. An acquirer shall not recognize goodwill related to service potential other than cash flows.

Measuring the Acquisition-Date Fair Value of the Acquirer's Interest in the Acquired Operation Using Valuation Techniques (see paragraph 87)

AG94. In an acquisition achieved without the transfer of consideration, the acquirer must substitute the acquisition-date fair value of its interest in the acquired operation for the acquisition-date fair value of the consideration transferred to measure goodwill, a loss or a gain on a bargain purchase (see paragraphs 85–87).

Special Considerations in Applying the Acquisition Method to Combinations of Mutual Entities (Application of Paragraph 87)

AG95. When two mutual entities combine, the fair value of the equity or member interests in the acquired operation (or the fair value of the acquired operation) may be more reliably measurable than the fair value of the member interests transferred by the acquirer. In that situation, paragraph 87 requires the acquirer to determine the amount of goodwill by using the acquisition-date fair value of the acquired operation's equity interests instead of the acquisition-date fair value of the acquirer's equity interests transferred as consideration. In addition, the acquirer in a combination of mutual entities shall recognize the acquired operation's net assets as a direct addition to capital or equity in its statement of financial position, not as an addition to accumulated surplus or deficit, which is consistent with the way in which other types of entities apply the acquisition method.

AG96. Although they are similar in many ways to other entities, mutual entities have distinct characteristics that arise primarily because their members are both customers and owners. Members of mutual entities generally expect to receive benefits for their membership, often in the form of reduced fees charged for goods and services or patronage dividends. The portion of patronage dividends allocated to each member is often based on the amount of business the member did with the mutual entity during the year.

AG97. A fair value measurement of a mutual entity should include the assumptions that market participants would make about future member benefits as well as any other relevant assumptions market participants would make about the mutual entity. For example, a present value technique may be used to measure the fair value of a mutual entity. The cash flows used as inputs to the model should be based on the expected cash flows of the mutual entity, which are likely to reflect reductions for member benefits, such as reduced fees charged for goods and services.

Determining what is Part of the Acquisition Transaction (see paragraphs 109–111)

AG98. The acquirer should consider the following factors, which are neither mutually exclusive nor individually conclusive, to determine whether a transaction is part of the exchange for the acquired operation or whether the transaction is separate from the acquisition:

(a) The reasons for the transaction. Understanding the reasons why the parties to the acquisition (the acquirer and the acquired operation and their owners, directors and managers—and their agents) entered into a particular transaction or arrangement may provide insight into whether it is part of the consideration transferred and the assets acquired or liabilities assumed. For example, if a transaction is arranged primarily for the benefit of the acquirer or the combined entity rather than primarily for the benefit of the acquired operation or its former owners before the combination, that portion of the transaction price paid (and any related assets or liabilities) is less likely to be part of the exchange for the acquired operation. Accordingly, the acquirer would account for that portion separately from the acquisition.

(b) Who initiated the transaction. Understanding who initiated the transaction may also provide insight into whether it is part of the exchange for the acquired operation. For example, a transaction or other event that is initiated by the acquirer may be entered into for the purpose of providing future economic benefits to the acquirer or combined entity with little or no benefit received by the acquired operation or its former owners before the combination. On the other hand, a transaction or arrangement initiated by the acquired operation or its former owners is less likely to be for the benefit of the acquirer or the combined entity and more likely to be part of the acquisition transaction.

(c) The timing of the transaction. The timing of the transaction may also provide insight into whether it is part of the exchange for the acquired operation. For example, a transaction between the acquirer and the acquired operation that takes place during the negotiations of the terms of an acquisition may have been entered into in contemplation of the acquisition to provide future economic benefits to the acquirer or the combined entity. If so, the acquired operation or its former owners before the acquisition are likely to receive little or no benefit from the transaction except for benefits they receive as part of the combined entity.

Effective Settlement of a Pre-Existing Relationship between the Acquirer and Acquired Operation in an Acquisition (see paragraph 110(a))

AG99. The acquirer and acquired operation may have a relationship that existed before they contemplated the acquisition, referred to here as a 'pre-existing relationship'. A pre-existing relationship between the acquirer and acquired operation may arise from a binding arrangement (for example, vendor and customer or licensor and licensee) or may arise outside of a binding arrangement (for example, plaintiff and defendant).

AG100. If the acquisition in effect settles a pre-existing relationship, the acquirer recognizes a gain or loss, measured as follows:

(a) For a pre-existing relationship arising outside of a binding arrangement (such as a lawsuit), fair value.

(b) For a pre-existing relationship arising from a binding arrangement, the lesser of (i) and (ii):

(i) The amount by which the binding arrangement is favorable or unfavorable from the perspective of the acquirer when compared with terms for current market transactions for the same or similar items. (An unfavorable binding arrangement is a binding arrangement that is unfavorable in terms of current market terms. It is not necessarily an onerous binding arrangement in which the unavoidable costs of meeting the obligations under the binding arrangement exceed the economic benefits expected to be received under it.)

(ii) The amount of any stated settlement provisions in the binding arrangement available to the counterparty to whom the binding arrangement is unfavorable.

If (ii) is less than (i), the difference is included as part of the acquisition accounting.

The amount of gain or loss recognized may depend in part on whether the acquirer had previously recognized a related asset or liability, and the reported gain or loss therefore may differ from the amount calculated by applying the above requirements.

AG101. A pre-existing relationship may be a binding arrangement that the acquirer recognizes as a reacquired right. If the binding arrangement includes terms that are favorable or unfavorable when compared with pricing for current market transactions for the same or similar items, the acquirer recognizes, separately from the acquisition, a gain or loss for the effective settlement of the binding arrangement, measured in accordance with paragraph AG100.

Arrangements for Contingent Payments to Employees or Selling Shareholders (see paragraph 110(b))

AG102. Whether arrangements for contingent payments to employees or selling shareholders are contingent consideration in the acquisition or are separate transactions depends on the nature of the arrangements. Understanding the reasons why the acquisition agreement includes a provision for contingent payments, who initiated the arrangement and when the parties entered into the arrangement may be helpful in assessing the nature of the arrangement.

AG103. If it is not clear whether an arrangement for payments to employees or selling shareholders is part of the exchange for the acquired operation or is a transaction separate from the acquisition, the acquirer should consider the following indicators:

(a) Continuing employment. The terms of continuing employment by the selling shareholders who become key employees may be an indicator of the substance of a contingent consideration arrangement. The relevant terms of continuing employment may be included in an employment agreement, acquisition agreement or some other document. A contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services. Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration.

(b) Duration of continuing employment. If the period of required employment coincides with or is longer than the contingent payment period, that fact may indicate that the contingent payments are, in substance, remuneration.

(c) Level of remuneration. Situations in which employee remuneration other than the contingent payments is at a reasonable level in comparison with that of other key employees in the combined entity may indicate that the contingent payments are additional consideration rather than remuneration.

(d) Incremental payments to employees. If selling shareholders who do not become employees receive lower contingent payments on a per-share basis than the selling shareholders who become employees of the combined entity, that fact may indicate that the incremental amount of contingent payments to the selling shareholders who become employees is remuneration.

(e) Number of shares owned. The relative number of shares owned by the selling shareholders who remain as key employees may be an indicator of the substance of the contingent consideration arrangement. For example, if the selling shareholders who owned substantially all of the shares in the acquired operation continue as key employees, that fact may indicate that the arrangement is, in substance, a profit-sharing arrangement intended to provide remuneration for post-combination services. Alternatively, if selling shareholders who continue as key employees owned only a small number of shares of the acquired operation and all selling shareholders receive the same amount of contingent consideration on a per-share basis, that fact may indicate that the contingent payments are additional consideration. The pre-acquisition ownership interests held by parties related to selling shareholders who continue as key employees, such as family members, should also be considered.

(f) Linkage to the valuation. If the initial consideration transferred at the acquisition date is based on the low end of a range established in the valuation of the acquired operation and the contingent formula relates to that valuation approach, that fact may suggest that the contingent payments are additional consideration. Alternatively, if the contingent payment formula is consistent with prior profit-sharing arrangements, that fact may suggest that the substance of the arrangement is to provide remuneration.

(g) Formula for determining consideration. The formula used to determine the contingent payment may be helpful in assessing the substance of the arrangement. For example, if a contingent payment is determined on the basis of a multiple of earnings, that might suggest that the obligation is contingent consideration in the acquisition and that the formula is intended to establish or verify the fair value of the acquired operation. In contrast, a contingent payment that is a specified percentage of earnings might suggest that the obligation to employees is a profit-sharing arrangement to remunerate employees for services rendered.

(h) Other agreements and issues. The terms of other arrangements with selling shareholders (such as agreements not to compete, executory contracts, consulting contracts and property lease agreements) and the income tax treatment of contingent payments may indicate that contingent payments are attributable to something other than consideration for the acquired operation. For example, in connection with the acquisition, the acquirer might enter into a property lease arrangement with a significant selling shareholder. If the lease payments specified in the lease arrangement are significantly below market, some or all of the contingent payments to the lessor (the selling shareholder) required by a separate arrangement for contingent payments might be, in substance, payments for the use of the leased property that the acquirer should recognize separately in its post-combination financial statements. In contrast, if the lease arrangement specifies lease payments that are consistent with market terms for the leased property, the arrangement for contingent payments to the selling shareholder may be contingent consideration in the acquisition.

Acquirer Share-Based Payment Awards Exchanged for Awards Held by the Acquired Operation's Employees (see paragraph 110(b))

AG104. An acquirer may exchange its share-based payment awards for awards held by employees of the acquired operation. The acquirer shall account for exchanges of share options or other share-based payment awards in conjunction with an acquisition in accordance with the relevant international or national accounting standard dealing with share-based payments.

AG105. In situations in which acquired operation awards would expire as a consequence of an acquisition and if the acquirer replaces those awards when it is not obliged to do so, the acquirer shall recognize any costs as remuneration cost in the post-combination financial statements in accordance with the relevant international or national accounting standard dealing with share-based payments. The cost of those awards shall not be included in measuring the consideration transferred in the acquisition.

Equity-Settled Share-Based Payment Transactions of the Acquired Operation

AG106. The acquired operation may have outstanding share-based payment transactions that the acquirer does not exchange for its share-based payment transactions. If vested, those acquired operation share-based payment transactions are part of the non-controlling interest in the acquired operation. If unvested, they are measured as if the acquisition date were the grant date. Share-based payment transactions are measured in accordance with the relevant international or national accounting standard dealing with share-based payments.

Subsequent Measurement and Accounting (see paragraph 112)

AG107. Examples of other IPSASs that provide guidance on subsequently measuring and accounting for assets acquired and liabilities assumed or incurred in an acquisition include:

(a) IPSAS 31 prescribes the accounting for identifiable intangible assets acquired in an acquisition. The acquirer measures goodwill at the amount recognized at the acquisition date less any accumulated impairment losses. IPSAS 26 prescribes the accounting for impairment losses.

(b) IPSAS 35 provides guidance on accounting for changes in a controlling entity's ownership interest in a controlled entity after control is obtained.

AG108. An acquirer should refer to the relevant international or national accounting standards for guidance on subsequently measuring and accounting for insurance contracts, income taxes and share-based payments.

Subsequent Measurement of Transfers, Concessionary Loans and Similar Benefits Received by an Acquirer or Acquired Operation on the Basis of Criteria that May Change as a Result of an Acquisition (see paragraph 114)

AG109. Prior to an acquisition taking place, an acquirer or an acquired operation may receive a transfer from a third party, based on specified criteria. For example, a national government may provide grants to those municipalities where the municipality's revenue per head of population is below a threshold. An acquisition by a municipality of a cash-generating operation may increase the revenue per head of population of the municipality so that it is above the threshold. This may cause the government to review the grant.

AG110. The acquirer shall not account for any revisions to the grant amount as part of the acquisition, but accounts for any revisions at the point the grantor makes its intentions known in accordance with other IPSASs.

AG111. Similar circumstances may arise in respect of concessionary loans and other benefits. The acquirer shall not account for any revisions to those transactions as part of the acquisition, but accounts for any revisions at the point the grantor makes its intentions known in accordance with other IPSASs.

Acquisitions Occurring during a Reporting Period

AG112. The resulting entity meets the needs of the users of its financial statements for information about the acquired operations prior to the acquisition by making the disclosures in paragraph 120(r).

AG113. To satisfy the requirements of a regulator, it may be necessary for the acquirer to present or disclose information in addition to that required by this Standard.

Transitional Provisions for Public Sector Combinations Involving Only Mutual Entities or by Contract Alone (see paragraph 133)

AG114. Paragraph 126 provides that this Standard applies prospectively to public sector combinations for which the acquisition date or amalgamation date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2019. Earlier application is permitted.

AG115. The requirement to apply this Standard prospectively has the following effect for a public sector combination involving only mutual entities or by contract alone if the acquisition date or amalgamation date for that public sector combination is before the application of this Standard:

(a) Classification. An entity shall continue to classify the prior public sector combination in accordance with the entity's previous accounting policies for such combinations.

(b) Previously recognized goodwill. At the beginning of the first annual period in which this Standard is applied, the carrying amount of goodwill arising from the prior public sector combination shall be its carrying amount at that date in accordance with the entity's previous accounting policies. In determining that amount, the entity shall eliminate the carrying amount of any accumulated amortization of that goodwill and the corresponding decrease in goodwill. No other adjustments shall be made to the carrying amount of goodwill.

(c) Goodwill previously recognized as a deduction from equity. The entity's previous accounting policies may have resulted in goodwill arising from the prior public sector combination being recognized as a deduction from equity. In that situation the entity shall not recognize that goodwill as an asset at the beginning of the first annual period in which this Standard is applied. Furthermore, the entity shall not recognize in surplus or deficit any part of that goodwill when it disposes of all or part of the operation to which that goodwill relates or when a cash-generating unit to which the goodwill relates becomes impaired.

(d) Subsequent accounting for goodwill. From the beginning of the first annual period in which this Standard is applied, an entity shall discontinue amortizing goodwill arising from the prior public sector combination and shall test goodwill for impairment in accordance with IPSAS 26.

(e) Previously recognized negative goodwill. An entity that accounted for the prior public sector combination by applying the purchase method may have recognized a deferred credit for an excess of its interest in the net fair value of the acquired operation's identifiable assets and liabilities over the cost of that interest (sometimes called negative goodwill). If so, the entity shall derecognize the carrying amount of that deferred credit at the beginning of the first annual period in which this Standard is applied with a corresponding adjustment to the opening balance of accumulated surplus or deficit at that date.

Appendix B

Amendments to Other IPSASs

[Deleted]

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 40.

Objective (paragraph 1)

BC1. In the absence of an International Public Sector Accounting Standard (IPSAS) dealing with public sector combinations, public sector entities are directed, in IPSAS 1, *Presentation of Financial Statements,* to look to other international or national accounting standards. In the case of public sector combinations, they may look to International Financial Reporting Standard (IFRS®) 3, *Business Combinations*. However, IFRS 3 requires all business combinations to be accounted for using acquisition accounting. In developing IFRS 3, the International Accounting Standards Board (IASB®) came to the conclusion that 'true mergers' or 'mergers of equals' in which none of the combining entities obtains control of the others are so rare as to be virtually non-existent. The IASB also observed that respondents and other constituents were unable to suggest an unambiguous and non-arbitrary boundary for distinguishing true mergers or mergers of equals from other business combinations and concluded that developing such an operational boundary would not be feasible (see IFRS 3, BC35). Consequently, the IASB decided that separate accounting requirements for such combinations was not necessary.

BC2. Many consider that in the public sector, mergers or amalgamations are the most common form of combination. As a result, public sector entities may not apply IFRS Standards when accounting for public sector combinations. This means that there may not be consistent or appropriate reporting of such combinations in general purpose financial statements (GPFSs). Consequently, users may not be able to obtain the information needed to identify the type of public sector combination and evaluate its nature and financial effect. The IPSASB believes this Standard will promote consistency and comparability in how public sector combinations are reported by public sector entities.

Process

BC3. In developing this Standard the IPSASB had regard to the discussion of control in IPSAS 35, *Consolidated Financial Statements*. The IPSASB considered how control, as defined in IPSAS 35, should influence the classification of public sector combinations in this Standard. The IPSASB also had regard to the guidance on combinations in the *Government Finance Statistics Manual* 2014 (GFSM 2014) with the aim of avoiding unnecessary differences. The IPSASB also considered IFRS 3 and guidance on combinations developed by national standard setters.

Alignment with Government Finance Statistics (GFS)

BC4. In developing this Standard, the IPSASB had regard to the treatment of public sector combinations in Government Finance Statistics (GFS):

GFS guidelines make a distinction between an acquisition and an amalgamation based on the principle that with an acquisition a transaction occurs, while with an amalgamation just a reclassification of units may occur.

A transaction will occur where a "market unit" is nationalized or privatized (that is, entering government control or leaving it), and the amounts are recorded in GFS as transactions in equity that correspond to the observed transaction price. Any changes in valuation–for example, between the opening balance of a government equity stake and the eventual transaction price–are recorded as revaluation effects, with no impact on government net lending/net borrowing. For amalgamations, the main impact is on the sectorization of the "institutional units".

Where the units before amalgamation belonged to the same sector or subsector of general government, the amalgamation will have no impact on the data for that sector or subsector. For example, an amalgamation of two local governments, where both are already classified to the local government sector, would not change results for the local government sector.

However, in cases where a unit in one subsector is being amalgamated with a unit in another subsector, the amalgamated units will be removed from the sector they belonged to and be added to the sector of the new amalgamated unit, through a reclassification of the unit (recorded in GFS as an "other volume change in assets and liabilities"). For example, if a local government unit is amalgamated with a state government, the unit will be reclassified from the local government subsector to the state government subsector.

BC5. The IPSASB agreed the approach in GFS was not an appropriate basis for classifying public sector combinations in this Standard, for the following reasons:

(a) The approach in GFS is based on a number of concepts that have no equivalent in IPSASs, for example:

(i) The classification of institutional units into sectors based on their economic nature; and

(ii) The distinction between market producers and nonmarket producers.

(b) Amalgamations in GFS can arise from a reclassification of units without a transaction being recorded, which is inconsistent with the approach in IPSASs; and

(c) Public sector combinations within the same sector or subsector of general government have no impact on the data in GFS, whereas IPSASs would require the changes to individual entities to be accounted for.

BC6. In coming to this conclusion the IPSASB noted that the different approaches in GFS and IPSASs may lead to similar accounting, for example:

(a) Nationalizations are likely to be recorded as acquisitions under both approaches; and

(b) The modified pooling of interests method of accounting will produce similar accounting to the GFS reclassification approach where the combining operations had previously adopted the same accounting policies.

Scope (paragraphs 2–4)

BC7. The IPSASB initially considered developing two Standards on public sector combinations, covering:

(a) Entity combinations arising from exchange transactions—a limited convergence project with IFRS 3; and

(b) Entity combinations arising from non-exchange transactions—a public sector-specific project.

BC8. In May 2009, the IPSASB issued Exposure Draft (ED) 41, *Entity Combinations from Exchange Transactions*, which was the limited convergence project with IFRS 3. Following the consultation process on ED 41, the IPSASB decided not to continue with this approach for the following reasons:

(a) IFRS 3 includes bargain purchases within its scope. It could be argued, therefore, that IFRS 3 also applies to at least some non-exchange entity combinations. The IPSASB acknowledged that it may be difficult to establish a clear demarcation between all exchange and non-exchange entity combinations.

(b) It was not clear whether combinations where no party gains control of the other parties to the combination would be classified as entity combinations arising from exchange transactions, and therefore required to be accounted for as an acquisition in accordance with ED 41.

BC9. Subsequently, the IPSASB decided to develop a single standard dealing with all public sector combinations. This wider scope was included in the Consultation Paper (CP), *Public Sector Combinations*, issued in June 2012. Respondents to the CP supported this wider scope.

BC10. The IPSASB, therefore, decided that this Standard should apply to all public sector combinations, with only limited exceptions. This Standard defines a public sector combination as the bringing together of separate operations into one public sector entity. This definition refers to the bringing together of operations rather than entities, as public sector combinations, in common with business combinations, may involve part of an entity that can be managed separately from the rest of the entity.

BC11. In coming to a decision on the scope of this Standard, the IPSASB agreed to include public sector combinations under common control. While these are excluded from the scope of IFRS 3, the IPSASB considered it important that this Standard included all public sector combinations within its scope.

Scope Exclusions

BC12. The IPSASB agreed that this Standard should not apply to the formation of joint arrangements or joint ventures. The IPSASB stated in the CP that:

> "The concept underlying the formation of a joint venture differs from other combinations, in that the formation arises from separate entities deciding to share control, i.e., they have joint control of the operations that form the joint venture. The concept of joint control may give rise to issues that affect how the joint venture itself should account for its formation."

BC13. In developing this Standard, the IPSASB discussed whether this rationale was still valid given that this Standard takes a different approach to classifying public sector combinations. The IPSASB concluded that the concept of joint control does not reflect the issues addressed in this Standard, and agreed to exclude the formation of joint arrangements or joint ventures from its scope.

BC14. The IPSASB noted that combinations of two or more joint arrangements may occur. The IPSASB considered that, where such a combination results in the formation of a new joint arrangement, this would be outside the scope of IPSAS 40. The IPSASB noted that a combination may result in the acquisition of one or more joint arrangements by another joint arrangement. In such circumstances, the entities that previously had control over the acquired joint arrangements give up that joint control. Such a combination would be an acquisition within the scope of IPSAS 40.

BC15. The IPSASB also agreed to exclude from the scope of this Standard the acquisition by an investment entity of an investment in a controlled entity that is required to be measured at fair value through surplus or deficit. Such transactions are considered to be investments rather than public sector combinations. IPSAS 35 prescribes the accounting requirements for such transactions.

Responses to ED 60, Public Sector Combinations

BC16. The IPSASB issued its proposals in ED 60, *Public Sector Combinations*, in January 2016. Respondents to ED 60 generally supported the proposed scope and the exclusions. The IPSASB considered the responses, and agreed that no changes to the scope were required. In doing so, the IPSASB noted that the scope of the standard included combinations undertaken on a temporary basis, for example the bailout of a private sector company with the intention of selling that company as soon as it was returned to a sound financial position. The IPSASB noted that including such combinations within the scope of this Standard was consistent with the decision taken in developing IPSAS 35 not to require a different accounting treatment for temporarily controlled entities.

Classification of Public Sector Combinations (paragraphs 7–14)

BC17. As a result of the responses it received to ED 41, the IPSASB concluded that distinguishing between entity combinations arising from exchange transactions and entity combinations arising from non-exchange transactions did not provide a suitable basis for a future IPSAS. Relying on the definition of "exchange transactions" in the IPSASB's literature would mean that most government interventions during times of economic crisis, such as the global financial crisis in 2008, would not meet the definition of an acquisition. The IPSASB considered it inappropriate to define such "bailouts" as amalgamations.

BC18. The IPSASB also noted that IFRS 3 applied to a "business", not to an entity. As well as applying to an entity, the definition of a business could also apply to part of an entity that could be managed separately from the rest of the entity. The IPSASB had regard to these issues in developing its approach in the CP.

Classification Approach in the Consultation Paper, Public Sector Combinations

BC19. The approach taken in the CP was to distinguish between combinations where the parties to the combination are under common control, and combinations where the parties to the combination are not controlled by the same ultimate controlling party, i.e., not under common control. A further distinction was made between combinations where one party gains control of another party (considered by the CP to be acquisitions), and combinations where no party gains control of the other parties to the combination (considered by the CP to be amalgamations).

BC20. The IPSASB considered that the concept of control was important in determining the classification of a public sector combination. Control underpins much of financial reporting. IPSAS 35 requires an entity to consolidate those other entities that it controls, as does the predecessor standard, IPSAS 6, *Consolidated and Separate Financial Statements*. The IPSASB also noted that Government Finance Statistics adopts a similar approach to control as that adopted in both IPSAS 35 and IPSAS 6.

BC21. Similarly, control is an important factor when recognizing assets. Paragraph 5.6 of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework) defines an asset as "A resource presently controlled by the entity as a result of a past event."

BC22. The IPSASB determined, therefore, that control was an appropriate starting point for the classification of public sector combinations. As a result, the CP included the IPSASB's preliminary view as to the role of control in classifying public sector combinations:

"The sole definitive criterion for distinguishing an amalgamation from an acquisition is that, in an amalgamation, none of the combining operations gains control of the other operations."

BC23. In developing the CP, the IPSASB explained that the parties to a public sector combination under common control are ultimately controlled by the same entity both before and after the combination. This leads to economic differences between combinations that take place under common control and those that take place not under common control, as follows:

(a) Public sector combinations between entities within an economic entity (i.e., under common control) do not change the economic resources of that economic entity;

(b) Any surpluses and deficits resulting from a public sector combination under common control are eliminated in full in the ultimate controlling entity's consolidated GPFSs; and

(c) The ultimate controlling entity can specify whether any consideration is transferred (and if consideration is transferred, the amount of that consideration) in a public sector combination under common control.

These differences may have implications for the accounting treatment of a public sector combination under common control.

BC24. The approach in the CP reflected the IPSASB's views that:

(a) The economic differences between combinations that take place under common control and those that take place not under common control may have implications for their accounting treatment; and

(b) Acquisitions should be distinguished from amalgamations on the basis of control.

BC25. Similar numbers of respondents to the CP supported and disagreed with the proposals. Respondents who disagreed with the proposals suggested that distinguishing acquisitions from amalgamations based solely on control did not reflect public sector circumstances. In particular, these respondents noted that

(a) Public sector combinations may occur where it is not possible to identify an acquirer even if it is possible to identify an entity that has gained control of operations as a result of the public sector combination. Under IFRS 3, the acquirer can be identified by analyzing the ownership interests in the respective parties. However, in the public sector there may be no quantifiable ownership interests in the entities, making such an analysis impossible. The entity gaining control of the operations may not have existed prior to the combination, and if there are no quantifiable ownership interests in that entity, it will not be possible to identify an acquirer.

(b) Public sector combinations may be imposed on all parties to the combination by a higher level of government, for example when a central government reorganizes local government by legislating the combination of municipalities irrespective of the wishes of those municipalities.

BC26. Respondents who disagreed with the proposals in the CP suggested a number of alternative bases for classifying public sector combinations, including:

(a) Variations of whether consideration was transferred:

(i) Consideration was transferred as part of the combination;

(ii) Significant consideration was transferred as part of the combination;

(iii) The combination was effected at market value;

(iv) Distinguishing acquisitions (which include the transfer of consideration) not under common control from all other combinations; and

(v) Distinguishing between combinations under common control on the basis of whether the combination has "commercial substance" (which includes the transfer of consideration).

(b) Whether the public sector combination was effected voluntarily or involuntarily.

Development of the Classification Approach in ED 60, Public Sector Combinations

BC27. The IPSASB considered the responses to the CP. The IPSASB accepted that the classification approach adopted in the CP would not always reflect public sector circumstances. Consequently, the IPSASB agreed to revisit the classification of public sector combinations.

BC28. As part of this process, the IPSASB considered whether any of the approaches suggested by respondents might provide an alternative basis for classification. The IPSASB concluded that these approaches were not suitable, for the following reasons:

(a) The IPSASB came to the view that the transfer of consideration, on its own, was insufficient to distinguish an acquisition from an amalgamation. As noted in paragraph BC17 above, defining an acquisition as an exchange transaction would lead to bailouts being classified as amalgamations. Similarly, if an acquisition was defined as requiring consideration to be transferred by the acquirer, this could lead to bailouts being classified as amalgamations. Definitions of an acquisition that required the transfer of significant consideration, or for the public sector combination to take place at market value, would not address issues such as bargain purchases (discussed above in paragraph BC8(a)).

(b) The IPSASB came to the view that whether a public sector combination was effected voluntarily or involuntarily did not provide, on its own, sufficient information to classify a public sector combination. The voluntary or involuntary nature of a public sector combination provides information as to the process of the combination but not its outcome. Public sector combinations may have different economic outcomes irrespective of their voluntary or involuntary nature. The IPSASB did not consider that it was possible to classify a public sector combination without considering the outcome of that combination. Consequently, the IPSASB did not consider a classification based solely on the voluntary or involuntary nature of the public sector combination would meet the objectives of financial reporting.

BC29. The IPSASB reviewed the role of control in classifying public sector combinations, and concluded that control remained an important factor in determining whether a combination was an acquisition or an amalgamation. In coming to this conclusion, the IPSASB noted that an acquisition could only occur when a party to the combination gained control of one or more operations (this is discussed in more detail in paragraph BC25(a) above). Consequently, the IPSASB reviewed the factors suggested by respondents to the CP to determine which factors might usefully supplement the concept of control.

BC30. The IPSASB discussed the following factors, and agreed that they could be helpful in supplementing the concept of control in classifying public sector combinations:

(a) **Consideration**. The IPSASB agreed that whether a public sector combination includes the transfer of consideration is relevant to classifying the combination. Acquisitions generally include consideration, whereas consideration will be absent from amalgamations. For the reasons given in paragraph BC28(a) above, the IPSASB agreed that the transfer of consideration in itself was not conclusive, and that more information about the nature of a combination would be obtained by having regard to the reasons why consideration was or was not transferred.

(b) **Exchange transactions**. The IPSASB agreed that an acquisition was more likely to occur in an exchange transaction than in a non-exchange transaction. However, the IPSASB had already acknowledged that it may be difficult to establish a clear demarcation between all exchange and non-exchange entity combinations (see paragraph BC8(a) above). The IPSASB came to the conclusion that information about whether a public sector combination was an exchange transaction or a non-exchange transaction could be determined by having regard to the reasons why consideration was or was not transferred. Consequently, the IPSASB concluded that it is not necessary to assess this factor independently of consideration.

(c) **Quantifiable ownership interests**. The IPSASB noted that whether there are quantifiable ownership interests in an operation can influence the economic substance of a public sector combination. If there are no quantifiable ownership interests in an operation, no consideration can be transferred as there is no party with an entitlement to receive the consideration. This can distinguish the combination from an acquisition, where there is always an owner to receive the consideration. The IPSASB noted that that lack of quantifiable ownership interests could be a reason why consideration was not transferred. Consequently, the IPSASB concluded that it is not necessary to assess this factor independently of consideration.

(d) **Decision-making process**. The IPSASB agreed that having regard to which parties were able to make decisions regarding a public sector combination could provide useful information about the classification of that combination. In the private sector, combinations are usually entered into voluntarily, at least from the acquirer's perspective. In the public sector, other parties may be involved in the decision-making process. The freedom that the parties to the combination are able to exercise may influence the economic substance of the combination and hence its classification.

(e) **Compulsion**. In the public sector, a public sector combination may be imposed by a higher level of government, whether or not that higher level of government controls the parties to the combination for financial reporting purposes. For example, a central government may restructure local government by directing certain municipalities to combine. The IPSASB agreed that compulsion was relevant to the classification of a public sector combination, but considered that information about compulsion would be obtained by having regard to decision-making. Consequently, the IPSASB concluded that it is not necessary to assess this factor independently of the decision-making process.

(f) **Common control**. In developing the CP, the IPSASB identified the economic differences between public sector combinations that take place under common control and those that take place not under common control (see paragraph BC23 above). The IPSASB agreed that the ability of the controlling entity to specify whether any consideration is transferred is relevant to the classification of the combination, but considered this to be an element of the decision-making process. The fact that the economic resources of the economic entity do not change in a combination under common control, and that any surpluses or deficits would be eliminated on consolidation were seen as relevant to the controlling entity, but not the controlled entity. As the controlled entity will be the reporting entity for the combination, the IPSASB concluded that it is not necessary to assess this factor independently of the decision-making process.

(g) **Citizens' rights**. In some jurisdictions, citizens may be part of the decision-making process, for example where public sector combinations are subject to the approval of citizens through a referendum. The IPSASB agreed that citizens' rights to accept or reject the combination was relevant to the classification of the combination. However, the IPSASB considered these rights to be rights to participate in the decision-making process. Consequently, the IPSASB concluded that it is not necessary to assess this factor independently of the decision-making process.

BC31. The IPSASB did not consider that the following factors would be helpful in supplementing the concept of control in classifying public sector combinations:

(a) **Change of sector**. The IPSASB acknowledged that a change of sector would be an indicator of a public sector entity acquiring an operation. However, the IPSASB considered that this change of sector would be a consequence of a change in control rather than a separate factor to be considered. The IPSASB also noted that the classification of institutional units into sectors based on their economic nature of being government units was a feature of GFS that had no equivalent in the IPSASB's literature. This will continue to be a significant difference between macroeconomic statistical reporting and accounting and financial reporting. Consequently, the IPSASB did not consider a change of sector to be a useful factor in classifying public sector combinations.

(b) **Nature of the jurisdiction**. Some responses to the CP suggested that, in jurisdictions where there is significant interaction or redistribution between the different levels of government, the public sector can be seen as operating as part of a single quasi "group" entity. Such a view could have implications for the classification of public sector combinations. The IPSASB did not consider that from the reporting entity's perspective, the nature of the jurisdiction was relevant to the classification of public sector combinations. A reporting entity could make an assessment of control, consideration and decision-making without reference to a quasi-group entity. The IPSASB noted that the nature of the jurisdiction may form part of the assessment of the nature of the public sector combination, which an entity may need to consider when the analysis of all other factors has produced inconclusive results or does not provide sufficient evidence to determine the appropriate classification of a public sector combination.

(c) **Operation of government**. Some respondents to the CP suggested that the operation of government would be relevant to the classification of public sector combinations. Examples given included:

(i) The existence of a ministerial or other government power enabling the government to direct the entity's governing body to achieve the government's policy objectives;

(ii) Ministerial approval is required for operating budgets; and

(iii) The government has broad discretion, under existing legislation, to appoint or remove a majority of the members of the governing body of the entity.

The IPSASB concluded that the examples were indicators of control or common control rather than suggesting an independent factor. As such, the IPSASB did not consider that the operation of government was relevant to the classification of public sector combinations.

(d) **The entity directs public policy and/or engages in non-market activity mainly financed by public resources**. Some respondents to the CP suggested that control should be supplemented by having regard to whether the entity directs public policy and/or engages in non-market activity mainly financed by public resources. Where this was the case, this would suggest an amalgamation. The IPSASB noted that this approach would require the introduction of new concepts into the IPSASB's literature. For example, non-market activity is a GFS concept that the IPSASB has not adopted. The IPSASB did not consider it appropriate to introduce these concepts in ED 60. Consequently, the IPSASB did not consider that this factor was relevant to the classification of public sector combinations.

(e) **Accountability**. Some respondents suggested that accounting for a public sector combination at fair value provides more information about the effect of that combination, but that this is only useful for accountability purposes where the entity was responsible for the decision to combine. The IPSASB did not consider accountability to be a primary factor in its own right, but acknowledged that the information resulting from the classification of a public sector combination should meet the objectives of financial reporting. In exceptional circumstances, when an analysis of consideration and the decision-making process produces an inconclusive result or does not provide sufficient evidence as to the appropriate classification of a public sector combination, an entity may need to consider other matters, including what information would meet the objectives of financial reporting and satisfy the qualitative characteristics (QCs).

BC32. The IPSASB concluded, therefore, that control should be supplemented by two additional factors–whether consideration was transferred, and the reasons for the presence or absence of consideration; and the decision-making process. These factors are wide ranging, and encompass elements of other factors, as discussed above.

BC33. The IPSASB noted that these factors could be used either to supplement the indicators of control in IPSAS 35, or could be used to supplement the control concept in classifying public sector combinations. The IPSASB debated the merits of these two approaches. The IPSASB noted that using the factors to supplement the indicators of control was likely to result in a classification approach that better satisfied the QC of comparability. However, the IPSASB considered that using the factors to supplement the control concept was likely to produce a classification approach that provided more relevant and faithfully representative information. Using the factors to supplement the control concept was also more likely to address the concerns raised by respondents.

BC34. Respondents to the CP had identified difficulties with distinguishing between acquisitions and amalgamations based solely on control that were unlikely to be fully addressed by further development of the indicators of control. The IPSASB agreed, and concluded that the gaining of control of operations by a party to the combination is an essential element of an acquisition, but is not sufficient in itself to determine whether a combination is an acquisition. Consequently, the IPSASB agreed to develop an approach to classifying public sector combinations that:

(a) Uses the factors to supplement the concept of control; and

(b) Considers control in the context of whether a party to the combination gains control of one or more operations as a result of the combination.

BC35. Having agreed to develop an approach that uses the factors to supplement control, the IPSASB discussed the relative importance to be attached to control and to the other factors in classifying public sector combinations. As part of this discussion, the IPSASB identified the following two approaches:

(a) **Rebuttable presumption approach**. Under this approach, when one party to the combination gains control of an operation, this creates a rebuttable presumption that the combination is an acquisition. This approach gives a strong weighting to the gaining of control, and the analysis of the other factors is focused on whether there is sufficient evidence to rebut this presumption.

(b) **Individual weighting approach.** Under this approach, the weightings given to the gaining of control, consideration and decision-making are a matter for professional judgment based on the individual circumstances of the combination. Preparers would identify which (if any) factors indicate an acquisition and which (if any) factors indicate an amalgamation. Where indicators of both an acquisition and an amalgamation are present, the weighting given to the respective factors by preparers using professional judgment would determine the classification.

BC36. The IPSASB noted that the rebuttable presumption approach provided greater clarity, and better satisfied the QC of comparability. The individual weighting approach was likely to be more subjective in practice. However, the IPSASB acknowledged that the individual weighting approach would enable practitioners to better reflect the economic substance of the combination, and might better meet the QCs of relevance and faithful representation.

BC37. Control was seen by most members as more important in determining the classification than the other factors, and the rebuttable presumption approach reflected this. Consequently, the IPSASB agreed to develop the rebuttable presumption approach.

BC38. In coming to this decision the IPSASB noted that an approach that considered other factors as supplementing control (which better satisfies the QCs of relevance and faithful representation at the expense of comparability) while at the same time incorporating a rebuttable presumption that one party to a combination gaining control of operations gives rise to an acquisition (which better satisfies the QC of comparability at the expense of relevance and faithful representation) is likely to produce an appropriate balance between the QCs.

BC39. The IPSASB also considered the possibility that, in rare circumstances, neither the consideration nor the decision-making indicators would be sufficient to rebut the presumption that a public sector combination was an acquisition even though this classification did not reflect the economic substance of the combination. The IPSASB agreed to require consideration of the economic substance of the combination when determining whether the presumption should be rebutted. To assist preparers in this determination, ED 60 also required, in these rare circumstances, an assessment as to which classification produces information that best satisfies the objectives of financial reporting and the QCs.

BC40. The IPSASB considered that the most common circumstances in which a public sector combination would be considered an acquisition are:

(a) One party to the combination gains control of an operation and pays consideration that is intended to compensate those with an entitlement to the net assets of the transferred operation for giving up that entitlement.

(b) One party to the combination gains control of an operation from outside the public sector without paying consideration to compensate those with an entitlement to the net assets of the transferred operations.

(c) One party to the combination gains control of an operation from outside the public sector by imposing the combination on the other party.

(d) One party to the combination gains control of an operation from a separate government.

The IPSASB noted that, except in exceptional cases, the classification approach adopted in ED 60 would result in such combinations being classified as acquisitions. This provided reassurance to the IPSASB that the approach adopted was appropriate.

Responses to ED 60

BC41. The IPSASB considered the responses to ED 60. The IPSASB noted that there was substantial support for the overall approach to classifying public sector combinations in the ED.

BC42. Respondents did, however, identify areas where they considered the approach could be improved. The main issues identified were:

(a) Having a rebuttable presumption that was expected to be rebutted significantly more frequently than not was confusing;

(b) The approach was seen as giving too much emphasis to control, with some stakeholders interpreting the ED as requiring the use of the acquisition method in most cases where one party to the combination gained control of operations; and

(c) In many jurisdictions, it will be easier to determine the economic substance of a public sector combination by reference to the indicators (consideration and decision making) than by reference to whether one party to the combination gained control of operations.

BC43. The IPSASB acknowledged these concerns. The IPSASB accepted that rebuttable presumptions are generally expected to be rebutted infrequently, and that the use of this term with an expectation that it would be frequently rebutted may be confusing for preparers. This confusion could result in a preparer classifying a public sector combination as an acquisition when this was not the IPSASB's intention.

BC44. The IPSASB considered that the potential confusion as to how the rebuttable presumption was to be interpreted might explain the concerns of some stakeholders that the acquisition method would be used inappropriately. The IPSASB did not intend that the approach in the ED would require the use of the acquisition method in most cases where one party to the combination gained control of operations. The IPSASB considered that acquisitions would arise in limited circumstances, as can be seen from the list in paragraph BC40 above.

BC45. The IPSASB accepted that, in many jurisdictions, the economic substance of a public sector combination could be more readily determined by reference to the indicators, in particular whether a combination occurred under common control. However, the IPSASB noted that this was not the case for all jurisdictions. The IPSASB noted that control remained a significant factor; in particular, an acquisition can only occur when a party to the combination gains control of one or more operations. The IPSASB also noted that the approach in ED 60 provided a suitable decision framework for ensuring all relevant factors were considered.

BC46. Consequently, the IPSASB agreed to reconsider the way the classification approach is expressed to address these concerns, without changing the substance of the approach. The rebuttable presumption and reference to control was intended to be the first step in the process of determining a classification based on the economic substance of the combination. In creating this first step, the IPSASB did not intend that, once it has been established that one party has gained control, control should be given greater weight than consideration and decision making in determining the economic substance of the combination. The IPSASB accepted that the reference in BC35(a) to the approach giving a strong weighting to the gaining of control could be misleading. Control remains important, as its absence eliminates the possibility of an acquisition, but its significance in determining the economic substance of a particular combination where one party has gained control is a matter of professional judgment. The IPSASB remains of the view that the classification approach in ED 60 was appropriate, and the changes introduced in this Standard are intended to provide greater clarity as to how the approach should be applied. These changes are not intended to produce different classifications from ED 60.

Comparison with IFRS 3

BC47. This Standard is not converged with IFRS 3. IFRS 3 considers all business combinations to be acquisitions, whereas this Standard provides for both amalgamations and acquisitions. The IPSASB considers this difference to be appropriate, for the following reasons:

(a) In developing IFRS 3, the IASB concluded that 'true mergers' or 'mergers of equals' in which none of the combining entities obtains control of the others are so rare as to be virtually non-existent. However, in the public sector, such combinations are common. Developing a Standard that did not address amalgamations would not meet the needs of the users of public sector GPFSs.

(b) IFRS 3 assumes that it is always possible to identify the acquirer, as the businesses to which IFRS 3 applies will always have owners. In the public sector, there may be no quantifiable ownership interests in a public sector entity, which can make it impossible to identify an acquirer. Developing a Standard that does not recognize this situation would not meet the needs of the users of public sector GPFSs.

Accounting for Amalgamations (paragraphs 15–57)

Reasons for Adopting the Modified Pooling of Interests Method of Accounting for Amalgamations

BC48. In developing the CP, the IPSASB identified three methods of accounting for public sector combinations that have either been applied in practice, or discussed. These are:

(a) The acquisition method;

(b) The pooling of interests method, including a possible modification to this method; and

(c) The fresh start method.

BC49. The acquisition method (which is applied by IFRS 3) requires that an acquirer is identified for all combinations. The IPSASB had already concluded that it may not be possible to identify an acquirer for all public sector combinations, and that any combination in which an acquirer could not be identified would be classified as an amalgamation. The IPSASB therefore concluded that the acquisition method of accounting would not be appropriate for amalgamations.

BC50. The pooling of interests method of accounting was previously used in IAS 22, *Business Combinations* (the predecessor standard to IFRS 3). It was intended for application to a combination in which an acquirer cannot be identified. The pooling of interests method of accounting was previously used by many jurisdictions as the basis for merger accounting or amalgamation accounting. It continues to be used by many entities when accounting for combinations under common control (which are outside the scope of IFRS 3).

BC51. The pooling of interests method accounts for the combining operations as though they were continuing as before, although now jointly owned and managed. The financial statement items of the combining operations for the period in which the combination occurs, and for any comparative periods disclosed, are included in the financial statements of the resulting entity as if they had been combined from the beginning of the earliest period presented. In other words, the recognition point is the beginning of the earliest period presented, and, consequently, comparative information is restated.

BC52. The IPSASB noted that some are of the view that the requirement to restate comparative information might be onerous and unnecessary. In the CP, the IPSASB consulted on a variation of the pooling of interests method of accounting, described as the modified pooling of interests method of accounting. Under the modified pooling of interests method, the resulting entity combines the items in the statement of financial position as at the date of the amalgamation.

BC53. The third method the IPSASB discussed in the CP was the fresh start method of accounting. In contrast to the pooling of interests method of accounting, the premise of the fresh start method is that the resulting entity is a new entity (irrespective of whether a new entity is formed) and therefore its history commences on that date. The modified pooling of interests method has a similar effect in practice.

BC54. The fresh start method requires recognition of all of the identifiable assets and liabilities of all the combining operations at fair value as at the date of the combination in the financial statements of the resulting entity. This includes recognizing identifiable assets and liabilities that were not previously recognized by the combining operations. In other words, the fresh start method uses the same recognition and measurement basis as the acquisition method, but applies it to all of the combining operations rather than just acquired operations.

BC55. In developing the CP, the IPSASB came to the conclusion that the pooling of interests method of accounting, the modified pooling of interests method of accounting and the fresh start method of accounting all provided a possible basis for accounting for amalgamations.

BC56. The IPSASB noted that the future cash flows and service potential of the resulting entity will generally be the same regardless of which method is used to account for the amalgamation. However, the presentation of the financial performance and financial position of the resulting entity differs significantly depending on the method applied. If preparers are given a free choice of method, this would reduce comparability between entities and over time.

BC57. Supporters of the pooling or modified pooling of interests method of accounting for amalgamations considered that these methods satisfy users' needs:

(a) For information for decision-making purposes; and

(b) To assess the accountability of the resulting entity for its use of resources.

This is because users of public sector entities' GPFSs use the information to assess how financial resources have been allocated and the financial condition of an entity. This information can be obtained by applying the pooling or modified pooling of interests methods of accounting.

BC58. These methods are seen as satisfying the QCs of relevance and faithful representation, because they reflect the amounts recognized in the financial statements of the combining operations before the amalgamation. The subsequent performance of the resulting entity, and its accountability for the management of those resources, can be assessed on the same basis as was used to assess accountability before the amalgamation.

BC59. The pooling or modified pooling of interests methods of accounting are seen as generally the least costly to apply, because they:

(a) Use the existing carrying amounts of the assets, liabilities, and net assets/equity of the combining operations; and

(b) Do not require identifying, measuring, and recognizing assets or liabilities not previously recognized before the amalgamation.

BC60. Supporters of the modified pooling of interests method of accounting consider it to be superior to the pooling of interests method because it portrays the amalgamation as it actually is. This is because it recognizes the assets and liabilities of the combining operations at the date of the amalgamation. Supporters consider this to be a faithful representation of the amalgamation.

BC61. Those who support the use of the modified pooling of interests method acknowledge that the history of the combining operations may help in assessing the performance of the resulting entity. In debating the merits of the different methods, the IPSASB acknowledged that adopting the modified pooling of interests method of accounting without addressing users' needs for historical information may not satisfy the objectives of financial reporting.

BC62. Others consider that the fresh start method of accounting is conceptually superior to both the pooling of interests method of accounting and its modified version, because the resulting entity is held accountable for the current value of the resources of the combining operations. It also provides more complete information of an amalgamation, because it recognizes the identifiable assets and liabilities of the combining operations, regardless of whether they were recognized prior to the amalgamation.

BC63. Supporters of the fresh start method of accounting consider that it satisfies users' needs:

(a) For information for decision-making purposes; and

(b) To assess the accountability of the resulting entity for its use of resources.

This is because it enables users to better assess the financial condition of the entity and how the financial resources have been allocated.

BC64. Supporters of the fresh start method of accounting consider that this method is, to a large extent, an extension of the use of fair value in the acquisition method of accounting. Consequently, they argue that if the acquisition method is adopted for acquisitions, there is no reason not to adopt similar accounting for amalgamations.

BC65. In developing the CP, the IPSASB came to the view that the modified pooling of interests method of accounting is the appropriate method to apply, because users' are able to assess the performance and accountability of the resulting entity without the entity having to remeasure its assets and liabilities. Furthermore, it recognizes the amalgamation on the date it takes place. The IPSASB noted that IPSASs permit revaluation to fair value subsequent to initial recognition if a resulting entity considers that this approach would provide more relevant information to users.

BC66. Respondents to the CP generally supported the IPSASB's view that the modified pooling of interests method of accounting is the appropriate method to apply to amalgamations. The IPSASB reconsidered the methods in developing ED 60, and identified no reason to change its previously stated view. The IPSASB therefore agreed that the modified pooling of interests method of accounting should be adopted for amalgamations in ED 60. In coming to this decision, the IPSASB agreed that the modified pooling of interests method of accounting should include appropriate disclosures to ensure that the users of public sector entities' GPFSs had access to the historical information they need.

BC67. Respondents to ED 60 generally agreed that the modified pooling of interests method of accounting is the appropriate method to apply to amalgamations. However, some respondents considered that the pooling of interests method of accounting provided better information, and only supported the modified pooling of interests method for cost/benefit reasons. These respondents considered that, in some circumstances, the benefits of providing prior period information would outweigh the cost of so doing. The IPSASB accepted this view, and agreed that resulting entities should be permitted, but not required, to present prior period information. The IPSASB decided that prior period information should not be restated, as doing so would require the use of a different recognition point, which would reduce comparability.

Exceptions to the Principle that Assets and Liabilities are Recognized and Measured at their Previous Carrying Amount

BC68. The modified pooling of interests method of accounting requires the resulting entity to recognize and measure the assets and liabilities of the combining operations at their previous carrying amounts, subject to the requirement to adjust the carrying amounts to conform to the resulting entity's accounting policies. The effects of all transactions between the combining operations, whether occurring before or after the amalgamation date, are eliminated in preparing the financial statements of the resulting entity.

BC69. The IPSASB considered the circumstances in which the application of these principles would not be appropriate. The IPSASB identified three circumstances in which an exception to the recognition and/or measurement principles would be appropriate:

(a) **Licenses and similar rights previously granted by one combining operation to another combining operation**. A license or similar right may have been granted by one combining operation to another combining operation and recognized as an intangible asset by the recipient. Applying the general principles would require this transaction to be eliminated. However, the IPSASB considered that, in granting the license or similar right, the recognition criteria for an intangible asset are met. Where internally generated intangible assets are not recognized, this is because of the problems in Identifying whether and when there is an identifiable asset that will generate expected future economic benefits or service potential; and in determining the cost of the asset reliably. Once a license or similar right has been granted to a recipient, this demonstrates that there is an identifiable asset that will generate future economic benefits or service potential. Similarly, the transaction will establish a cost for the asset. Consequently, the recognition criteria for an intangible asset are met. Because of this, the asset is not eliminated when combining operations that have granted and received the license or similar right are part of an amalgamation. The situation is similar to that where a tangible asset is sold by one combining operation to another combining operation. Eliminating the effect of the sale does not eliminate the tangible asset itself, as the asset was previously recognized by the seller. In the case of a license or similar right, eliminating the transaction does not eliminate the intangible asset, as the transaction provides sufficient evidence of the existence of the intangible asset, such that the grantor would itself recognize that intangible asset. The IPSASB noted that in some cases where a combining operation gains control of other operations, the right might be considered as a reacquired right. The IPSASB did not consider that this would warrant a different accounting treatment, and noted that reacquired rights are recognized as intangible assets under the acquisition method. For these reasons, the IPSASB concluded that the asset recognized in respect of a license or similar right previously granted by one combining operation to another should not be eliminated.

(b) **Income taxes**. In the public sector, amalgamations, especially those imposed by a higher level of government, may include tax forgiveness as part of the terms and conditions of the amalgamation. The IPSASB agreed that the resulting entity should recognize any tax items that exist following the amalgamation rather than those that existed prior to the amalgamation. Having considered comments by respondents to ED 60, the IPSASB agreed that there may be cases where any tax forgiveness arises subsequent to the amalgamation, rather than as part of the terms and conditions of the amalgamation. The IPSASB agreed to include provisions dealing with both cases in IPSAS 40.

(c) **Employee benefits**. The IPSASB noted that the assets and liabilities required to be recognized by IPSAS 39, *Employee Benefits*, in respect of a post-employment benefit plan following an amalgamation might differ from the combined carrying amounts of the combining operations' equivalent amounts. As an example, an amalgamation involves five combining operations who are the only participants in a multi-employer defined benefit plan. Prior to the amalgamation, the combining operations have insufficient information to determine each combining operation's proportionate share of the defined benefit obligation, plan assets, and cost associated with the plan. As a result, the combining operations account for the plan as if it is a defined contribution plan. Following the amalgamation, the resulting entity is the only participant in the plan, and is able to determine its defined benefit obligation, plan assets, and cost associated with the plan. It therefore accounts for the plan as a defined benefit plan from the date of the amalgamation. The IPSASB agreed that the resulting entity's opening statement of financial position should include the assets and liabilities measured in accordance with IPSAS 39.

Recognizing and Measuring Components of Net Assets/Equity Arising as a Result of an Amalgamation

BC70. In developing ED 60, the IPSASB noted that a residual amount might arise as a result of an amalgamation. The IPSASB considered how this should be recognized and measured. The IPSASB agreed that the residual amount does not reflect the financial performance of the resulting entity, and concluded that the residual amount should be recognized in the resulting entity's opening statement of financial position.

BC71. The IPSASB considered the nature of the residual amount. The IPSASB considered that, for amalgamations not under common control, the residual amount represents the past financial performance of the combining operations not included in their transferred net assets/equity. The IPSASB agreed that the residual amount should be included in the resulting entity's opening net assets/equity where the amalgamation takes place not under common control.

BC72. The IPSASB considered that, for amalgamations under common control, the residual amount represents the financial consequences of decisions made by the controlling entity in setting or accepting the terms of the amalgamation. Consequently, the IPSASB agreed that the residual amount should be treated as an ownership contribution or ownership distribution where the amalgamation takes place under common control.

BC73. The IPSASB considered the items that should be included in the residual amount. The IPSASB noted that the modified pooling of interests method of accounting usually recognizes an amalgamation as giving rise to, in substance, a new entity on the date the amalgamation takes place. As the new entity would not have generated other components of net assets/equity such as accumulated surplus or deficit, or revaluation surplus, all items within net assets/equity would be included as part of the residual amount.

BC74. The IPSASB considered that this approach best reflects the conceptual basis of an amalgamation and agreed that all items within net assets/equity at the amalgamation date should be considered to be part of the residual amount. In coming to this view, the IPSASB accepted that this approach may have consequences for some entities. For example, because the residual amount would include any previously recognized revaluation surplus, any future revaluation decreases are more likely to be recognized in surplus or deficit. This is because the previously recognized revaluation surplus would no longer be available to absorb future revaluation decreases.

BC75. Another consequence relates to amalgamations that take place under common control. The resulting entity would recognize a residual amount but the controlling entity would continue to recognize the previous components of net assets/equity in its consolidated financial statements, giving rise to ongoing consolidation adjustments. The IPSASB did not consider that these consequences outweighed the benefits of adopting the conceptual approach.

Responses to ED 60

BC76. Although the majority of respondents to ED 60 supported the IPSASB's approach to the residual amount, a significant minority did not. The main reasons respondents gave for not supporting the proposed treatment of the residual amount were as follows:

(a) Retaining existing reserves better represents the combination, is more transparent and better meets users' needs;

(b) The proposals will result in reliable information on the revaluation reserve being discarded;

(c) For amalgamations under common control, the combining entities may effectively be continuing as one entity rather than as two or more separate entities, as opposed to being a new entity;

(d) Reporting subsequent revaluation losses as an expense risks misrepresenting financial performance in future years;

(e) The proposals will produce ongoing consolidation adjustments where the amalgamation takes place under common control, and the need to prepare these adjustments outweighed the benefits of recognizing a single residual amount; and

(f) The proposals will impact on a wide range of reserves, including those relating to employee benefits, hedging and reserves restricted by legislation, which would be inconsistent with ED 60's requirement that the existing classifications and designations are maintained.

BC77. The IPSASB was persuaded by some of the reasons provided by respondents. In particular the IPSASB acknowledged that the proposals in ED 60 might be internally inconsistent.

BC78. The IPSASB therefore reconsidered the proposal to require all amounts recognized in net assets/equity to be recognized in the residual amount.

BC79. The IPSASB concluded that the most appropriate presentation of net assets/equity would depend on the circumstances of the amalgamation. In an amalgamation not under common control, and where there were no reserves such as those referred to in paragraph BC76(f) above, presenting a single opening balance in net assets/equity could provide faithfully representative information. In an amalgamation under common control, and with reserves such as those referred to in paragraph BC76(f) above, presenting a single opening balance in net assets/equity is unlikely to provide faithfully representative information. In these circumstances, presenting separate components of net assets/equity will provide more relevant and useful information.

BC80. Consequently, the IPSASB decided not to specify which components of net assets/equity should be presented, as preparers will be in the best position to judge the most appropriate treatment. The IPSASB agreed to amend the requirements accordingly.

Measurement Period

BC81. IFRS 3 permits acquirers a period of one year after the acquisition date to complete the accounting for the acquisition. This is to allow the acquirer sufficient time to obtain information to determine the fair value of an acquired operation's assets and liabilities.

BC82. The IPSASB considered whether such a period was required when accounting for an amalgamation. The modified pooling of interests method does not require assets and liabilities to be restated to fair value at the amalgamation date. However, the IPSASB noted that the combining operations may have different accounting policies, which could result in some assets and liabilities being required to be restated to conform to the resulting entity's accounting policies. For example, the resulting entity may adopt an accounting policy of revaluing certain assets such as property, plant and equipment. If one or more combining operations had previously adopted an accounting policy of measuring such assets at cost, the practical effect of determining the carrying amount of those assets under the revaluation model would be similar to that of determining their fair value. For this reason, the IPSASB agreed that it was appropriate to permit a resulting entity time to obtain the information needed to restate assets and liabilities to conform to its accounting policies. The IPSASB agreed that a period of one year was appropriate.

Combining Operations that Have Not Previously Adopted Accrual Basis IPSASs

BC83. In developing this Standard, the IPSASB considered whether it was necessary to include specific provisions to address the situation where one or more combining operations had not previously adopted accrual basis IPSASs. For example, one public sector entity that has previously applied accrual basis IPSASs may be amalgamated with a second public sector entity that has previously applied an alternative accrual basis of accounting. In such circumstances, recognizing and measuring the second public sector entity's assets and liabilities at their carrying amount may not be consistent with the requirements of accrual basis IPSASs.

BC84. The IPSASB concluded that no separate provisions were required in this Standard. Paragraph 27 of IPSAS 40 requires the resulting entity to adjust the carrying amounts of the identifiable assets and liabilities of the combining operations where required to conform to the resulting entity's accounting policies. The IPSASB considered this requirement to be sufficient to address most circumstances where one or more combining operations had not previously adopted accrual basis IPSASs.

BC85. The IPSASB came to the view that where adjusting the carrying amounts to conform to the resulting entity's accounting policies was insufficient to achieve compliance with accrual basis IPSASs, the resulting entity would be a first-time adopter of accrual basis IPSASs. This could occur where one or more combining operations had previously adopted the cash basis of accounting and had, therefore, not previously recognized certain assets and liabilities. In these circumstances, the resulting entity would apply IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* in preparing its first post-combination financial statements.

Accounting for Acquisitions (Paragraphs 58–125)

Reasons for Adopting the Acquisition Method of Accounting for Acquisitions

BC86. In developing the CP, the IPSASB did not reach a conclusion as to "whether the use of fair value as the measurement basis, is appropriate for some or all acquisitions in the public sector. This is because the most prevalent types of acquisition occur where operations are acquired for the achievement of objectives relating to the delivery of goods and/or services, instead of generating economic benefits to return to equity holders. Moreover, many acquisitions do not include the transfer of consideration. Some consider that these types of acquisitions are different in nature from business combinations as identified in IFRS 3, because the concept of acquiring an operation directly in exchange for the transfer of consideration is missing." Respondents to the CP generally supported the use of fair value for acquisitions in which consideration was transferred. For acquisitions in which no consideration was transferred, there was broadly equal support for fair value measurement and measurement at carrying amount.

BC87. The arguments developed in the CP reflected the classification approach in the CP. In the CP, the IPSASB proposed that the gaining of control was the sole definitive criterion for distinguishing an amalgamation from an acquisition. The IPSASB has subsequently decided to supplement the gaining of control with two other factors, consideration and decision-making. The IPSASB considers that this will result in fewer public sector combinations being classified as acquisitions than under the approach in the CP. Those public sector combinations that are classified as acquisitions will be similar in nature to the business combinations addressed by IFRS 3.

BC88. Having regard to the revised classification approach that it had agreed to adopt, the IPSASB reconsidered which accounting method would be appropriate for acquisitions. The IPSASB concluded that the acquisition method was appropriate, and agreed to adopt the acquisition method as set out in IFRS 3 as the accounting method for acquisitions in this Standard. This approach was supported by respondents to ED 60.

Differences to the Accounting Treatments in IFRS 3

BC89. IFRS 3 includes accounting treatments that are based on other IFRS Standards for which there is no equivalent IPSAS, for example income taxes and share-based payment. The IPSASB agreed not to include the detailed requirements specified in IFRS 3, but to include references to the relevant international or national accounting standard dealing with the issue.

BC90. The IPSASB considered whether any additional guidance to that provided by IFRS 3 was required. The IPSASB noted that acquisitions in the public sector may include assets and liabilities arising from non-exchange transactions that are not addressed in IFRS 3. Consequently, the IPSASB agreed to include additional guidance on the following non-exchange items:

(a) Tax forgiveness; and

(b) The subsequent measurement of transfers, concessionary loans and similar benefits received by a combining operation on the basis of criteria that may change as a result of an acquisition.

BC91. The IPSASB considered comments from respondents to ED 60 regarding the acquisition method. As a result, the IPSASB agreed to make minor changes to the requirements:

The tax forgiveness requirements have been amended to allow for those cases where tax forgiveness occurs subsequent to the acquisition as well as where it forms part of the terms of the acquisition.

The IPSASB considered whether any additional exemptions to the recognition and measurement principles or any additional guidance on the acquisition method were required. The IPSASB concluded that no further provisions were necessary, as the Board considered that the provisions in this Standard or in other IPSASs were already sufficiently clear.

Acquired Operations that Have Not Previously Adopted Accrual Basis IPSASs

BC92. In developing this Standard, the IPSASB considered whether it was necessary to include specific provisions to address the situation where one or more acquired operations had not previously adopted accrual basis IPSASs. The IPSASB concluded that no separate provisions were required in this Standard. Paragraph 64 of IPSAS 40 requires an acquirer to recognize the identifiable assets acquired, the liabilities assumed and any non-controlling interest in an acquired operation. Paragraph 72 of the Standard requires the acquirer to measure the assets and liabilities acquired at their acquisition-date fair values. Consequently, the acquirer will measure all assets and liabilities in accordance with accrual basis IPSASs, irrespective of the accounting basis previously adopted by an acquired operation.

Fair Value Cannot be Determined

BC93. Respondents to ED 60 commented that, in exceptional circumstances, it may be impracticable for an acquirer to determine the fair value of an item and suggested that the use of the item's previous carrying amount may be an appropriate alternative. The IPSASB considered this suggestion but concluded that using carrying amount may not be appropriate in all instances, particularly if the acquired operation does not apply accrual based IPSASs. The IPSASB agreed that entities should apply the existing requirements in IPSASs. In particular, the IPSASB noted that, in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. IPSAS 3 provides additional guidance. In such cases, the acquirer would measure the item as of the acquisition date in a manner that is consistent with other IPSASs and the acquirer's accounting policies, and make the disclosures required by other IPSASs. The IPSASB considered that it would be appropriate to measure the item at its previous carrying amount only where that carrying amount is consistent with other IPSASs and the acquirer's accounting policies.

Revision of IPSAS 40 as a result of *Improvements to IPSAS, 2018*

BC94. The IPSASB reviewed the revisions to IFRS 3, *Business Combinations, included in Annual Improvements to IFRS® Standards 2015–2017* Cycle issued by the IASB in December 2017, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions. The IPSASB concurred that, as the accounting for an acquisition achieved in stages was the same in IPSAS 40 as in IFRS 3, there was no public sector specific reason for not adopting the amendments.

Revision of IPSAS 40 as a result of *Improvements to IPSAS, 2019*

BC95. The paragraph related to IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* was inadvertently omitted when IPSAS 40 was issued. The IPSASB added paragraph 126C to ensure consistency with IPSAS 33.

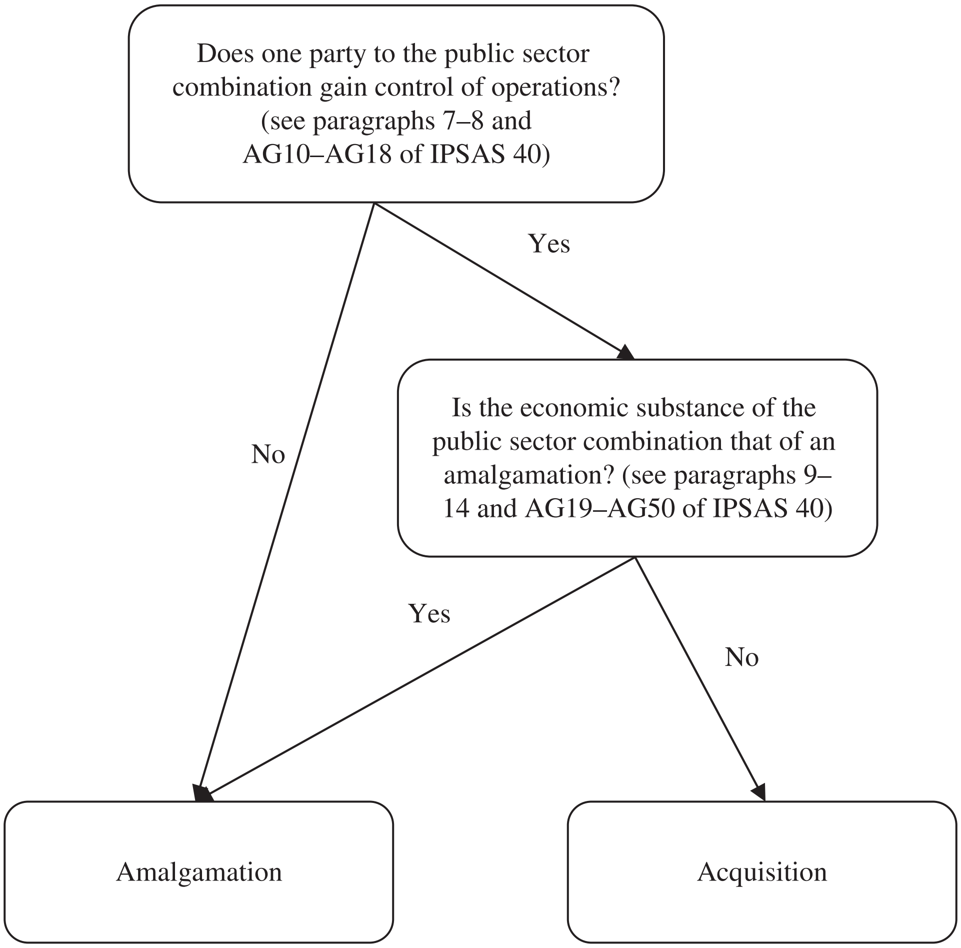
Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 40.

IG93. The purpose of this Implementation Guidance is to illustrate certain aspects of the requirements of IPSAS 40.

Classification of Public Sector Combinations

IG94. The diagram below summarizes the process established by IPSAS 40 for classifying public sector combinations.



Illustrative Examples

These examples accompany, but are not part of, IPSAS 40.

Classification of Public Sector Combinations

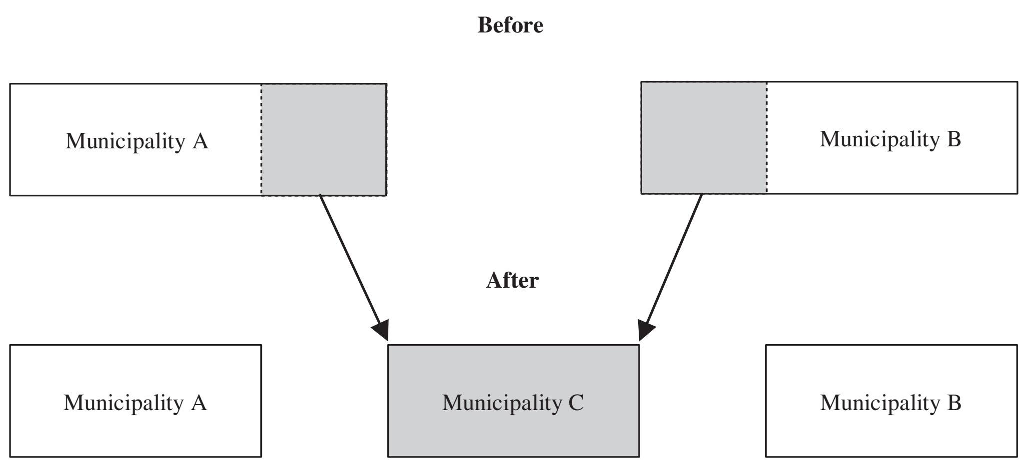
Illustrating the Consequences of Applying Paragraphs 7–14 and AG10–AG50 of IPSAS 40

IE1. The following scenarios illustrate the process for classifying public sector combinations. These scenarios portray hypothetical situations. Although some aspects of the scenarios may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying IPSAS 40.

IE2. Each scenario is illustrated by a diagram. Where a public sector combination involves operations which form part of an economic entity, but not the whole economic entity, the operations that are involved in the combination, and the entity that is formed by the combination, are shaded in the diagram. Where more than one reporting entity is included in an economic entity, the boundary of the economic entity is shown by a dotted line.

Scenario 1: Reorganization of Local Government by Rearranging Territorial Boundaries

IE3. The following diagram illustrates the creation of a new municipality by combining some operations from two existing municipalities.



IE4. In this scenario, the territorial boundaries of two existing municipalities, Municipality A and Municipality B, are redrawn by Parliament through legislation; neither Parliament nor Central Government controls Municipality A or Municipality B. Responsibility for part of each municipality's former territory is transferred to a new municipality, Municipality C. Operations in respect of the transferred territory are combined to form Municipality C. A public sector combination occurs.

IE5. Municipality A and Municipality B remain otherwise unchanged and retain their governing bodies. A new governing body (unrelated to the governing bodies of Municipality A and Municipality B) is elected for Municipality C to manage the operations that are transferred from the other municipalities.

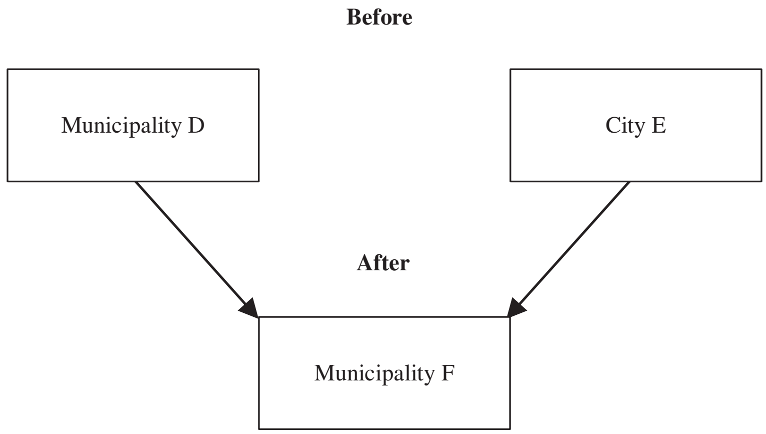
IE6. The creation of Municipality C is a public sector combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question to consider is whether one of the parties to the combination has gained control of operations as a result of the combination.

IE7. Municipality C has a newly elected governing body, unrelated to the governing bodies of Municipality A and Municipality B. Neither Municipality A nor Municipality B has power over the Municipality C. Neither do they have exposure, or rights, to variable benefits from any involvement with Municipality C.

IE8. Neither Municipality A nor Municipality B have gained control over Municipality C as a result of the public sector combination. Consequently the combination is classified as an amalgamation.

Scenario 2: Reorganization of Local Government by Combining Municipalities into a New Legal Entity

IE9. The following diagram illustrates the creation of a new municipality by combining all of the operations of two existing municipalities into a new legal entity.



IE10. In this scenario, a public sector combination occurs in which Municipality F is formed to combine the operations (and the related assets, liabilities and components of net assets/equity) of Municipality D and City E. Prior to the combination, Municipality D and City E are not under common control. The combination is imposed by the provincial government (a third party) through legislation. The provincial government has the legal power to direct the two entities to combine, through legislation, even though it does not control them.

IE11. The legislation that creates Municipality F provides for the formation of a new governing body with no links to Municipality D or City E. Municipality D and City E have no role in determining the terms of the combination. After the combination, Municipality D and City E cease to exist.

IE12. The creation of Municipality F is a public sector combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question to consider is whether one of the parties to the combination has gained control of operations as a result of the combination.

IE13. Municipality F has a newly formed governing body, unrelated to the governing bodies of Municipality D and City E. Neither Municipality D nor City E has power over Municipality F. Neither do they have exposure, or rights, to variable benefits from any involvement with Municipality F.

IE14. Neither Municipality D nor City E have gained control over Municipality F as a result of the public sector combination. Consequently the combination is classified as an amalgamation.

Scenario 2: Variation

IE15. In scenario 2, the legislation that creates Municipality F provides for the formation of a new governing body with no links to Municipality D or City E. In this variation, the legislation that creates Municipality F provides for the governing body of Municipality D to become the governing body of Municipality F.

IE16. This suggests that as part of the public sector combination that creates Municipality F, Municipality D is gaining control of the operations of City E. However, the assessment as to whether Municipality D is gaining control is based on the substance of the combination, not its legal form. In preparing its first financial statements, Municipality F considers the guidance in paragraphs 7–8 and AG10–AG18 of IPSAS 40.

IE17. In this variation, it is assumed that the legislation that provides for the governing body of Municipality D to become the governing body of Municipality F results in Municipality D gaining:

(a) Power over the operations of City E;

(b) Exposure, or rights, to variable benefits from its involvement with those operations; and

(c) The ability to use its power over those operations to affect the nature or amount of the benefits from its involvement with those operations.

IE18. Municipality F concludes that, as a result of the public sector combination, Municipality D has gained control of City E. Municipality F considers the guidance in paragraphs 9–14 and AG19–AG50 of IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE19. In considering the economic substance of the public sector combination, Municipality F notes that the combination does not result in a controlling entity/controlled entity relationship between Municipality D and City E. This is consistent with both an amalgamation and an acquisition. Municipality F also notes that Municipality D obtains access to economic benefits or service potential that are similar to those that could have been obtained by mutual agreement; this may suggest that the economic substance of the combination is that of an acquisition, but is not conclusive.

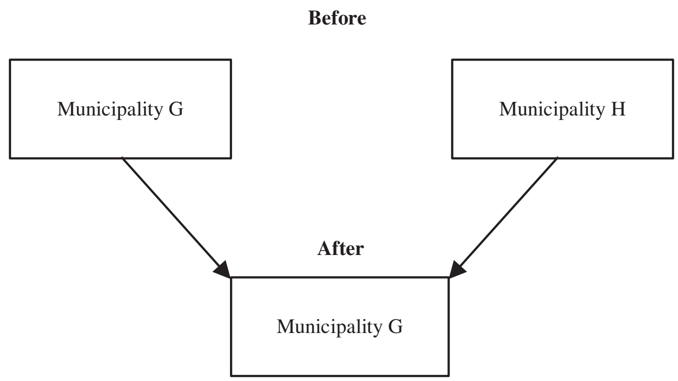
IE20. In considering the indicators relating to consideration, Municipality F notes that the public sector combination does not include the payment of consideration because there is no party with an entitlement to the net assets of City E (i.e., there are no former owners of City E with quantifiable ownership interests). This suggests that the economic substance of the combination is that of an amalgamation.

IE21. In considering the indicators relating to the decision-making process, Municipality F notes that the public sector combination was imposed by the provincial government (a third party) and that Municipality D and City E had no role in determining the terms of the combination. This may suggest that the economic substance of the combination is that of an amalgamation.

IE22. Taking these factors together, Municipality F considers that the public sector combination should be classified as an amalgamation. In coming to this decision, Municipality F considers the absence of consideration because there is no party with an entitlement to the net assets of an operation to be the most significant factor in determining the economic substance of the combination.

Scenario 3: Reorganization of Local Government by Combining Municipalities into an Existing Legal Entity

IE23. The following diagram illustrates the combining of all of the operations of two existing municipalities into an existing legal entity.



IE24. In this scenario, a public sector combination occurs in which the operations of Municipality G and Municipality H (and their related assets, liabilities and components of net assets/equity) are combined into the legal entity of Municipality G. Prior to the combination, Municipality G and Municipality H are not under common control. The combination is imposed by Central Government (a third party) through legislation. Central Government has the legal power to direct the two entities to combine, through legislation, even though it does not control them.

IE25. The legislation that effects the combination provides for the governing body of Municipality G to continue as the governing body of the combined entity. Municipality G and Municipality H have no role in determining the terms of the combination. After the public sector combination, Municipality H ceases to exist.

IE26. These facts suggest that as part of the public sector combination, Municipality G is gaining control of the operations of Municipality H. However, the assessment as to whether Municipality G is gaining control is based on the substance of the combination, not its legal form. Municipality G considers the guidance in paragraphs 7–8 and AG10–AG18 of IPSAS 40 in determining whether to classify the combination as an amalgamation or an acquisition.

IE27. In this scenario, it is assumed that the legislation that provides for the governing body of Municipality G to continue as the governing body of combined entity results in Municipality G gaining:

(a) Power over the operations of Municipality H;

(b) Exposure, or rights, to variable benefits from its involvement with those operations; and

(c) The ability to use its power over those operations to affect the nature or amount of the benefits from its involvement with those operations.

IE28. Municipality G concludes that, as a result of the public sector combination, it has gained control of Municipality H. Municipality G considers the guidance in paragraphs 9–14 and AG19–AG50 of IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE29. In considering the economic substance of the public sector combination, Municipality G notes that the combination does not result in a controlling entity/controlled entity relationship between Municipality G and Municipality H. This is consistent with both an amalgamation and an acquisition. Municipality G also notes that it obtains access to economic benefits or service potential that are similar to those that could have been obtained by mutual agreement; this may suggest that the economic substance of the combination is that of an acquisition, but is not conclusive.

IE30. In considering the indicators relating to consideration, Municipality G notes that the public sector combination does not include the payment of consideration because there is no party with an entitlement to the net assets of Municipality H (i.e., there are no former owners of Municipality H with quantifiable ownership interests). This suggests that the economic substance of the combination is that of an amalgamation.

IE31. In considering the indicators relating to the decision-making process, Municipality G notes that the public sector combination was imposed by Central Government (a third party) and that Municipality G and Municipality H had no role in determining the terms of the combination. This may suggest that the economic substance of the combination is that of an amalgamation.

IE32. Taking these factors together, Municipality G considers that the public sector combination should be classified as an amalgamation. In coming to this decision, Municipality G considers the absence of consideration because there is no party with an entitlement to the net assets of an operation to be the most significant factor in determining the economic substance of the combination.

Scenario 3: Variation

IE33. In scenario 3, the legislation provides for the governing body of Municipality G to become the governing body of the combined entity. In this variation, the legislation provides for a new governing body to be formed that has no links to Municipality G or Municipality H.

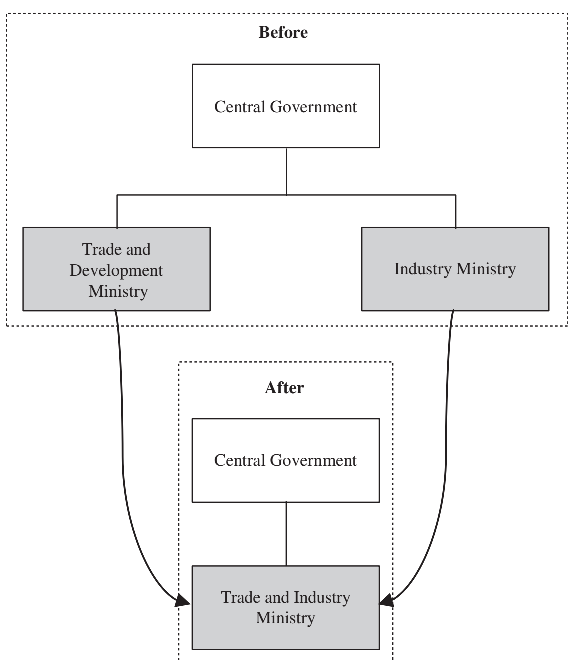
IE34. In determining whether this public sector combination should be classified as an amalgamation or an acquisition, the first question to consider is whether one of the parties to the combination has gained control of operations as a result of the combination.

IE35. Despite its legal form continuing, Municipality G has a newly formed governing body, unrelated to its previous governing body or that of Municipality H. Consequently, the previous Municipality G does not gain power over Municipality H. Neither does it have exposure, or rights, to variable benefits from any involvement with Municipality H.

IE36. Municipality G has not gained control over Municipality H as a result of the public sector combination. Consequently the combination is classified as an amalgamation.

Scenario 4: Restructuring of Central Government Ministries

IE37. The following diagram illustrates the reorganization of Central Government ministries by combining the Trade and Development Ministry and the Industry Ministry into the newly formed Trade and Industry Ministry.



IE38. In this scenario, a public sector combination occurs in which the Trade and Industry Ministry is formed to combine the operations (and the related assets, liabilities and components of net assets/equity) of the Trade and Development Ministry and the Industry Ministry. All the ministries, both prior to and after the combination, are controlled by Central Government. The combination is imposed by Central Government using this control. The Trade and Development Ministry and the Industry Ministry have no role in determining the terms of the combination.

IE39. In effecting the combination, Central Government gives responsibility for the new Trade and Industry Ministry to the Minister of Industry and the governing body of the Industry Ministry. After the combination, the Trade and Development Ministry and the Industry Ministry cease to exist.

IE40. As Central Government controls the same operations both before and after the public sector combination, Central Government does not report a combination in its consolidated financial statements. The combination is reported by the Trade and Industry Ministry.

IE41. The creation of the Trade and Industry Ministry is a public sector combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question to consider is whether one of the parties to the combination has gained control of operations as a result of the combination.

IE42. Central Government gives responsibility for the new Trade and Industry Ministry to the Minister of Industry and the governing body of the Industry Ministry. This suggests that as part of the public sector combination that creates the new Trade and Industry Ministry, the Industry Ministry is gaining control of the operations of the Trade and Development Ministry. However, the assessment as to whether the Industry Ministry is gaining control is based on the substance of the combination, not its form. In determining whether the combination should be classified as an amalgamation or an acquisition, the Trade and Industry Ministry considers the guidance in paragraphs 7–8 and AG10–AG18 of IPSAS 40.

IE43. In this scenario, it is assumed that the decision of Central Government to give responsibility for the new Trade and Industry Ministry to the Minister of Industry and the governing body of the Industry Ministry results in the Industry Ministry gaining:

(a) Power over the operations of the Trade and Development Ministry;

(b) Exposure, or rights, to variable benefits from its involvement with those operations; and

(c) The ability to use its power over those operations to affect the nature or amount of the benefits from its involvement with those operations.

IE44. The Trade and Industry Ministry concludes that, as a result of the public sector combination, the Industry Ministry has gained control of the Trade and Development Ministry. The Trade and Industry Ministry considers the guidance in paragraphs 9–14 and AG19–AG50 of IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE45. In considering the economic substance of the public sector combination, the Trade and Industry Ministry notes that the combination does not result in a controlling entity/controlled entity relationship between the Trade and Development Ministry and the Industry Ministry. This is consistent with both an amalgamation and an acquisition. The Trade and Development Ministry also notes that the Industry Ministry obtains access to economic benefits or service potential that are similar to those that could have been obtained by mutual agreement; this may suggest that the economic substance of the combination is that of an acquisition.

IE46. In considering the indicators relating to consideration, the Trade and Industry Ministry notes that the public sector combination does not include the payment of consideration because the combination took place under common control, and Central Government, the controlling entity, did not specify any consideration in the terms of the combination. Consequently, although the absence of consideration may suggest that the economic substance of the combination is that of an amalgamation, this is not of itself conclusive and other factors also need to be taken into account.

IE47. In considering the indicators relating to the decision-making process, the Trade and Industry Ministry notes that the public sector combination takes place under common control. The combination was directed by Central Government and the Trade and Development Ministry and the Industry Ministry had no role in determining the terms of the combination. This provides evidence that the ultimate decision as to whether the combination took place, and the terms of the combination, are determined by the Central Government, the controlling entity. This provides evidence that the economic substance of the combination is that of an amalgamation.

IE48. Taking these factors together, the Trade and Industry Ministry considers that the public sector combination should be classified as an amalgamation. In coming to this decision, the fact that the public sector combination takes place under common control is considered to be the most significant factor in determining the economic substance of the combination.

Scenario 4: Variation

IE49. In scenario 4, Central Government gives responsibility for the new Trade and Industry Ministry to the Minister of Industry and the governing body of the Industry Ministry. In this variation, Central Government appoints a new Minister and governing body.

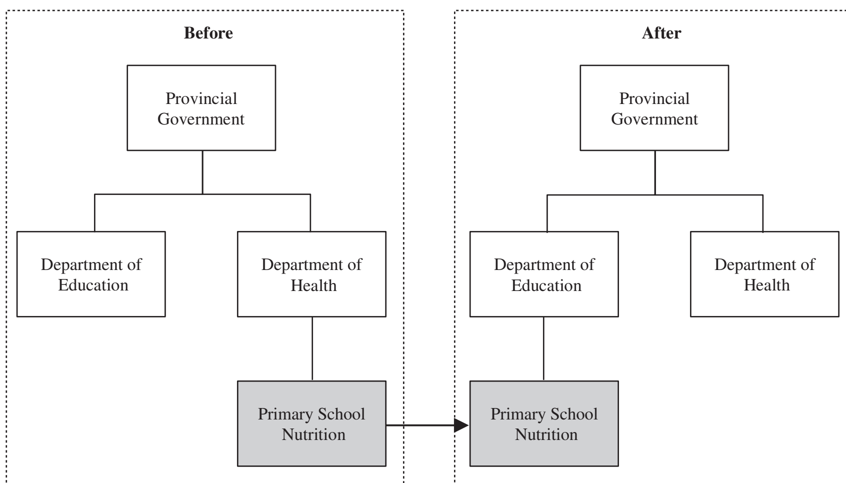
IE50. The creation of the Trade and Industry Ministry is a public sector combination under common control. In determining whether this should be classified as an amalgamation or an acquisition, the first question to consider is whether one of the parties to the combination has gained control of operations as a result of the combination.

IE51. The Trade and Industry Ministry has a new Minister and a newly formed governing body, unrelated to the governing bodies of the Trade and Development Ministry and the Industry Ministry. Neither the Trade and Development Ministry or the Industry Ministry has gained power over the operations of the other ministry. Neither do they have exposure, or rights, to variable benefits from any involvement with the operations of the other ministry.

IE52. Neither of the Trade and Development Ministry nor the Industry Ministry has gained control over the Trade and Industry Ministry as a result of the public sector combination. Consequently the combination is classified as an amalgamation.

Scenario 5: Transfer of Operations Under Common Control

IE53. The following diagram illustrates the transfer of operations between two public sector entities that are under common control.



IE54. In this scenario, a public sector combination occurs in which the Primary School Nutrition operation is transferred from the Provincial Government's Department of Health to its Department of Education. Both departments are controlled by the Provincial Government prior to and after the combination.

IE55. As the Provincial Government controls the same operations both before and after the public sector combination, the Provincial Government does not report a combination in its consolidated financial statements. The combination is reported by the Department of Education.

IE56. The transfer of the Primary School Nutrition operation is a public sector combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question the Department of Education considers is whether one of the parties to the combination has gained control of operations as a result of the combination.

IE57. In this scenario, the Department of Education gains:

(a) Power over the Primary School Nutrition operation;

(b) Exposure, or rights, to variable benefits from its involvement with that operation; and

(c) The ability to use its power over that operation to affect the nature or amount of the benefits from its involvement with that operation.

IE58. The Department of Education concludes that, as a result of the public sector combination, it has gained control of the Primary School Nutrition operation. The Department of Education considers the guidance in paragraphs 9–14 and AG19–AG50 of IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE59. In considering the economic substance of the public sector combination, the Department of Education notes that it obtains access to economic benefits or service potential that are similar to those that could have been obtained in a voluntary transaction; this may suggest that the economic substance of the combination is that of an acquisition.

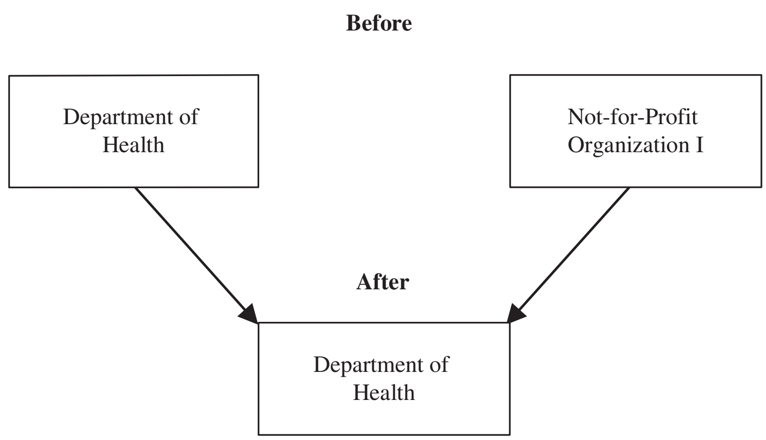
IE60. In considering the indicators relating to consideration, the Department of Education notes that the public sector combination does not include the payment of consideration because the combination took place under common control, and the Provincial Government, the controlling entity, did not specify any consideration in the terms of the combination. Consequently, although the absence of consideration may suggest that the economic substance of the combination is that of an amalgamation, this is not of itself conclusive and other factors also need to be taken into account.

IE61. In considering the indicators relating to the decision-making process, the Department of Education notes that the public sector combination takes place under common control. The combination was directed by the Provincial Government. This provides evidence that the ultimate decision as to whether the combination took place, and the terms of the combination, are determined by the Provincial Government, the controlling entity. This provides evidence that the economic substance of the combination is that of an amalgamation.

IE62. Taking these factors together, the Department of Education considers that the public sector combination should be classified as an amalgamation. In coming to this decision, the fact that the public sector combination takes place under common control is considered to be the most significant factor in determining the economic substance of the combination.

Scenario 6: Combination of a Public Sector Entity with a Not-For-Profit Organization

IE63. The following diagram illustrates the combination of a public sector entity with a not-for-profit organization providing similar services.



IE64. In this scenario, a public sector combination occurs in which Not-for-Profit Organization I, a charity which provides paramedic services, voluntarily agrees to combine with the Department of Health in order to improve the delivery of services to the public. The operations of Not-for-Profit Organization I are integrated with similar operations provided by the Department of Health. Prior to the combination, the Department of Health has provided funding for Not-for-Profit Organization I. The Department of Health meets the cost of transferring the title to the assets and liabilities of Not-for-Profit Organization I incurred by the trustees of the charity.

IE65. The combination of the Department of Health and Not-for-Profit Organization I is a public sector combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question the Department of Health considers is whether it has gained control of operations as a result of the combination.

IE66. In this scenario, the Department of Health gains:

(a) Power over Not-for-Profit Organization I and its operations;

(b) Exposure, or rights, to variable benefits from its involvement with those operations; and

(c) The ability to use its power over those operations to affect the nature or amount of the benefits from its involvement with those operations.

IE67. The Department of Health concludes that, as a result of the public sector combination, it has gained control of Not-for-Profit Organization I. The Department of Health considers the guidance in paragraphs 9–14 and AG19–AG50 of IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE68. In considering the economic substance of the public sector combination, the Department of Health notes that the combination does not result in a controlling entity/controlled entity relationship between the Department and Not-for-Profit Organization I. This is consistent with both an amalgamation and an acquisition.

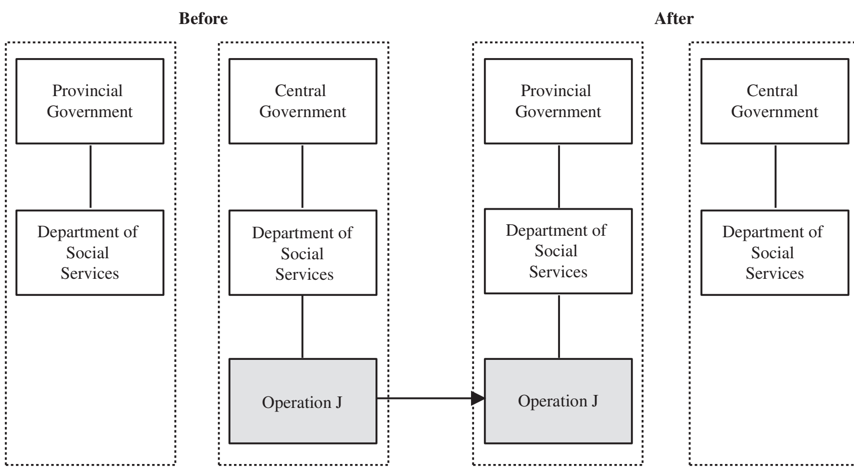
IE69. In considering the indicators relating to consideration, the Department of Health notes that the public sector combination does not include the payment of consideration that is intended to compensate the seller for giving up their entitlement to the net assets of an operation. Although the Department of Health makes a payment to the trustees, this is to compensate them for costs incurred in effecting the combination, not to compensate them for giving up their entitlement to the net assets of Not-for-Profit Organization I. Although Not-for-Profit Organization I has a Board of Trustees, these individuals are not entitled to the net assets of the operation. This means there is no party with an entitlement to the net assets of Not-for-Profit Organization I (i.e., there are no former owners of Not-for-Profit Organization I with quantifiable ownership interests).This suggests that the economic substance of the combination is that of an amalgamation. In this scenario, this is confirmed by the fact that the purpose of the combination is to improve the delivery of services to the public.

IE70. In considering the indicators relating to the decision-making process, the Department of Health notes that the public sector combination was a voluntary combination. Consequently, these indicators do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE71. Taking these factors together, the Department of Health considers that the public sector combination should be classified as an amalgamation. In coming to this decision, the Department of Health considers the absence of consideration because there is no party with an entitlement to the net assets of an operation to be the most significant factor in determining the economic substance of the combination. In this scenario, this view is reinforced by the fact that that Board of Trustees is voluntarily giving up control over the operations to improve the delivery of services to the public.

Scenario 7: Transfer of an Operation Between Levels of Government

IE72. The following diagram illustrates the transfer of an operation between levels of government.



IE73. In this scenario, Central Government adopts a policy of devolving responsibility for some social services to the Provincial Government. Consequently, it proposes transferring Operation J, which provides residential care services, from Central Government's Department of Social Services to the Provincial Government's Department of Social Services. The Provincial Government supports the policy and agrees to accept Operation J. Operation J has net assets of CU1,000[2]. There is no transfer of consideration by the Provincial Government to the Central Government. However, the transfer agreement imposes an obligation on the Provincial Government to continue to provide the residential care services for a minimum of 10 years. Operation J does not recover all its costs from charges; the Provincial Government therefore assumes the responsibility for providing resources to meet the shortfall. Following the transfer, the Provincial Government operates Operation J as a stand-alone entity (i.e., there is a controlling entity/controlled entity relationship between the Provincial Government and Operation J), although it plans to integrate the operation with its other operations at a later date, which would remove the controlling entity/controlled entity relationship.

[2] In these examples monetary amounts are denominated in 'currency units (CU)'

IE74. The transfer of Operation J is a public sector combination that will need to be reported in both the Provincial Government's financial statements and those of the Provincial Government's Department of Social Services. As the analysis required will be the same for both entities, this example uses the term Provincial Government to refer to both entities.

IE75. In determining whether this should be classified as an amalgamation or an acquisition, the first question the Provincial Government considers is whether it has gained control of operations as a result of the combination.

IE76. In this scenario, the Provincial Government gains:

(a) Power over Operation J;

(b) Exposure, or rights, to variable benefits from its involvement with Operation J; and

(c) The ability to use its power over Operation J to affect the nature or amount of the benefits from its involvement with the operation.

IE77. The Provincial Government concludes that, as a result of the public sector combination, it has gained control of Operation J. The Provincial Government considers the guidance in paragraphs 9–14 and AG19–AG50 of IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE78. In considering the economic substance of the public sector combination, the Provincial Government notes that the combination results in a controlling entity/controlled entity relationship between the Provincial Government and Operation J. This is inconsistent with the economic substance of an amalgamation.

IE79. In considering the indicators relating to consideration, the Provincial Government notes that the public sector combination does not include the payment of consideration that is intended to compensate the seller for giving up their entitlement to the net assets of an operation. However, the transfer agreement requires the Provincial Government to continue to provide the services. As Operation J does not recover all its costs from charges, the Provincial Government will need to provide the necessary resources to cover the shortfall. The Provincial Government considers that the cost of providing services for the agreed 10 year period is likely to be approximately equal to the value of the net assets received. It therefore considers that a market participant would estimate the fair value of Operation J (with the obligation to provide services for 10 years) to be zero. Although no consideration is transferred, this reflects the fair value of the combination. The Provincial Government concludes that the indicators relating to consideration do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE80. In considering the indicators relating to the decision-making process, the Provincial Government notes that the public sector combination is a voluntary combination. Consequently, these indicators do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE81. Taking these factors together, the Provincial Government concludes that there is no evidence that economic substance of the combination is that of an amalgamation, and that the public sector combination should, therefore, be classified as an acquisition.

Scenario 7: Variation

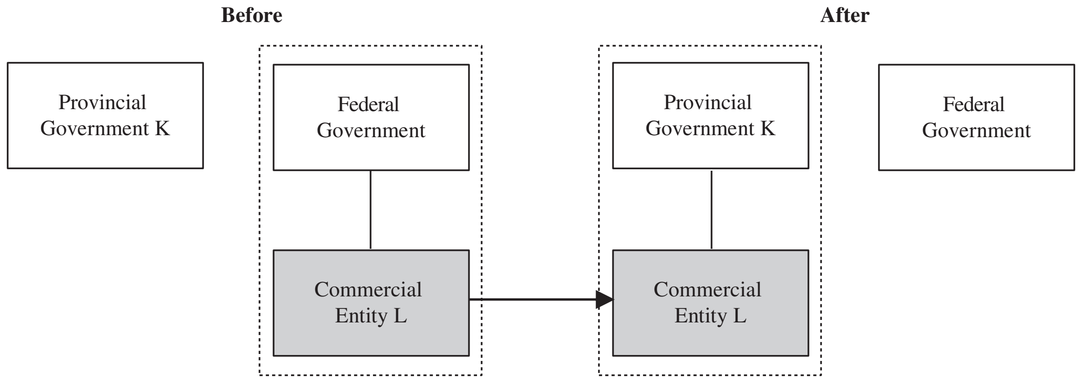
IE82. In scenario 7, the Provincial Government considers that a market participant would estimate the fair value of Operation J (with the obligation to provide services for 10 years) to be zero. This is the reason that no consideration is paid. In this variation, Operation J is assumed to cover its costs from charges. Consequently, a market participant would estimate the fair value of Operation J (with the obligation to provide services for 10 years) to be greater than zero.

IE83. In these circumstances, the fact that the combination does not include the payment of consideration that is intended to compensate the seller for giving up their entitlement to the net assets of an operation may provide evidence that the economic substance of the combination is that of an amalgamation.

IE84. In determining the classification of the public sector combination, the Provincial Government considers which factor or factors are the most significant. The Provincial Government considers the fact that it has gained control of Operation J and the fact that the combination does not involve the integration of its operations and those of Operation J to be the most significant factors in determining the economic substance of the combination. This suggests that the combination should be classified as an acquisition. The indicators relating to the decision-making process support this classification; only the indicators relating to consideration suggest that the economic substance of the combination may be an amalgamation. The Provincial Government therefore classifies the combination as an acquisition.

Scenario 8: Transfer of a Commercial Entity between Levels of Government

IE85. The following diagram illustrates the transfer of a commercial entity between levels of government.



IE86. In this scenario, the Federal Government agrees to transfer Commercial Entity L to Provincial Government K. Provincial Government K pays consideration to the Federal Government in respect of the transfer. Following the combination, Provincial Government K operates Commercial Entity L as an arms-length, stand-alone entity.

IE87. The transfer of Commercial Entity L is a public sector combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question Provincial Government K considers is whether it has gained control of operations as a result of the combination.

IE88. In this scenario, Provincial Government K gains:

(a) Power over Commercial Entity L and its operations;

(b) Exposure, or rights, to variable benefits from its involvement with those operations; and

(c) The ability to use its power over those operations to affect the nature or amount of the benefits from its involvement with those operations.

IE89. Provincial Government K concludes that, as a result of the public sector combination, it has gained control of Commercial Entity L. Provincial Government K considers the guidance in paragraphs 9–14 and AG19–AG50 of IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE90. In considering the economic substance of the public sector combination, Provincial Government K notes that the combination results in a controlling entity/controlled entity relationship between the Provincial Government and Commercial Entity L. This is inconsistent with the economic substance of an amalgamation. Provincial Government K also notes that the combination has commercial substance, which is suggestive of an acquisition.

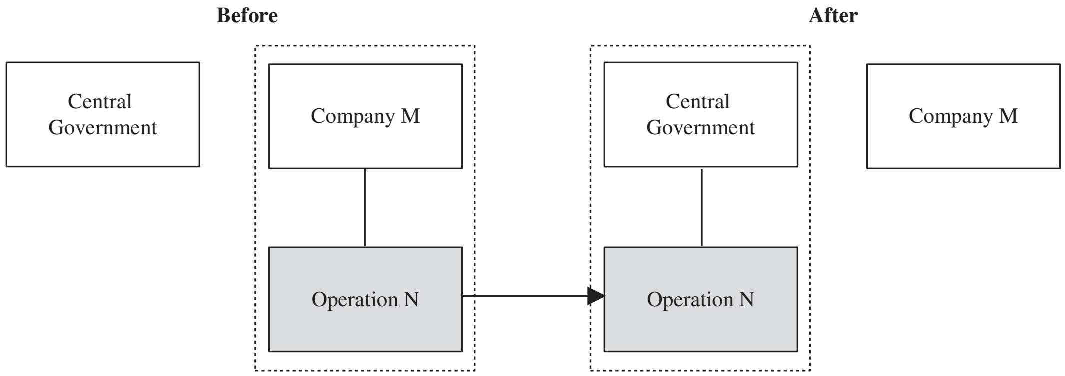
IE91. In considering the indicators relating to consideration, Provincial Government K notes that the public sector combination includes the payment of consideration that is intended to compensate the seller for giving up their entitlement to the net assets of an operation. Provincial Government K concludes that the indicators relating to consideration do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE92. In considering the indicators relating to the decision-making process, Provincial Government K notes that the public sector combination is a voluntary combination. Consequently, these indicators do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE93. Taking these factors together, Provincial Government K concludes that there is no evidence that the economic substance of the combination is that of an amalgamation, and that the public sector combination should, therefore, be classified as an acquisition.

Scenario 9: Purchase of a Private Sector Operation

IE94. The following diagram illustrates the purchase of a private sector operation by a public sector entity.



IE95. In this scenario, Central Government purchases Operation N from Company M. Central Government pays the market value of Operation N, and Company M acts voluntarily. Following the purchase, Operation N is managed as an arms-length, stand-alone entity.

IE96. The purchase of Operation N is a public sector combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question Central Government considers is whether it has gained control of operations as a result of the combination.

IE97. In this scenario, Central Government gains:

(a) Power over Operation N;

(b) Exposure, or rights, to variable benefits from its involvement with Operation N; and

(c) The ability to use its power over Operation N to affect the nature or amount of the benefits from its involvement with that operation.

IE98. Central Government concludes that, as a result of the public sector combination, it has gained control of Operation N. Central Government considers the guidance in paragraphs 9–14 and AG19–AG50 of IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE99. In considering the economic substance of the public sector combination, Central Government notes that the combination results in a controlling entity/controlled entity relationship between Central Government and Operation N. This is inconsistent with the economic substance of an amalgamation. Central Government also notes that the combination has commercial substance, which is suggestive of an acquisition.

IE100. In considering the indicators relating to consideration, Central Government notes that the public sector combination includes the payment of consideration that is intended to compensate the seller for giving up their entitlement to the net assets of an operation. Central Government concludes that the indicators relating to consideration do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE101. In considering the indicators relating to the decision-making process, Central Government notes that the public sector combination is a voluntary combination. Consequently, these indicators do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE102. Taking these factors together, Central Government concludes that there is no evidence that the economic substance of the combination is that of an amalgamation, and that the public sector combination should, therefore, be classified as an acquisition.

Scenario 9: Variation

IE103. In scenario 9, Company M enters into the transaction voluntarily. In this variation, Central Government nationalizes Operation N through a compulsory purchase. The purchase is still effected at the market value of Operation N.

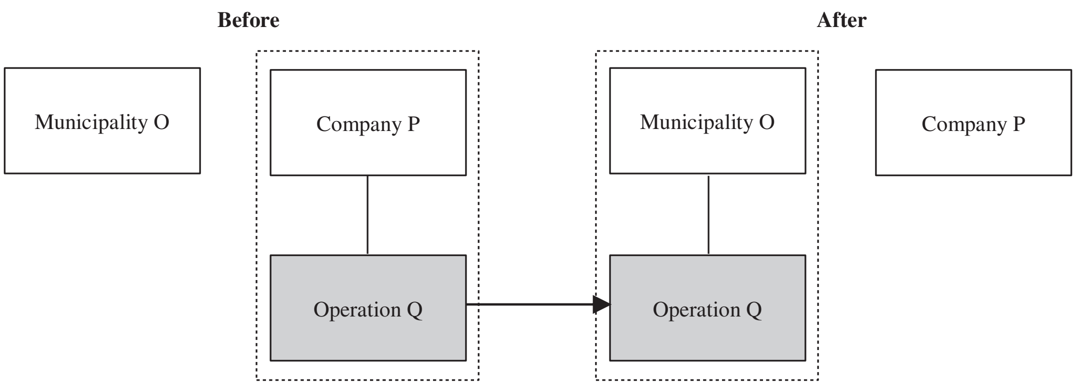
IE104. The change from a voluntary transaction to a compulsory purchase does not affect the assessments of control or the indicators related to consideration.

IE105. In considering the indicators relating to the decision-making process, Central Government notes that Company M does not act voluntarily. The fact that Central Government (a party to the combination) is able to impose the public sector combination on Company M provides evidence that the economic substance of the combination is that of an acquisition.

IE106. Consequently, Central Government classifies the public sector combination as an acquisition.

Scenario 10: Bargain Purchase

IE107. The following diagram illustrates a bargain purchase by a public sector entity.



IE108. In this scenario, Municipality O purchases Operation Q from Company P in a bargain purchase. Company P is seeking to sell Operation Q quickly to release cash for its other operations, and is willing to accept a price below the market value of Operation Q for an early sale. In entering into the bargain purchase, Company P acts voluntarily. Following the purchase, Operation Q is managed as an arms-length, stand-alone entity by Municipality O.

IE109. The bargain purchase of Operation Q is a public sector combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question Municipality O considers is whether it has gained control of operations as a result of the combination.

IE110. In this scenario, Municipality O gains:

(a) Power over Operation Q;

(b) Exposure, or rights, to variable benefits from its involvement with Operation Q; and

(c) The ability to use its power over Operation Q to affect the nature or amount of the benefits from its involvement with that operation.

IE111. Municipality O concludes that, as a result of the public sector combination, it has gained control of Operation Q. Municipality O considers the guidance in paragraphs 9–14 and AG19–AG50 of IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE112. In considering the economic substance of the public sector combination, Municipality O notes that the combination results in a controlling entity/controlled entity relationship between Municipality O and Operation Q. This is inconsistent with the economic substance of an amalgamation. Municipality O also notes that the combination has commercial substance (even though the price paid was below the market price of Operation Q), which is suggestive of an acquisition.

IE113. In considering the indicators relating to consideration, Municipality O notes that the public sector combination includes the payment of consideration that is intended to compensate the seller for giving up their entitlement to the net assets of an operation, even though that price was below market value. Company P voluntarily accepted a lower price for a quick sale, and the purpose of the consideration paid was to provide Company P with the level of compensation for giving up its entitlement to the net assets of Operation Q that it was willing to accept. Municipality O concludes that the indicators relating to consideration do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE114. In considering the indicators relating to the decision-making process, Municipality O notes that the public sector combination is a voluntary combination. Consequently, these indicators do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE115. Taking these factors together, Municipality O concludes that there is no evidence that the economic substance of the combination is that of an amalgamation, and that the public sector combination should, therefore, be classified as an acquisition.

Scenario 10: Variation

IE116. In scenario 10, Company P enters into the transaction voluntarily. In this variation, Municipality O seizes Operation Q through a compulsory purchase. The purchase is still effected at a price below the market value of Operation Q. Company P would not have sold Operation Q for a price below market value voluntarily.

IE117. The change from a voluntary transaction to a compulsory purchase does not affect the assessment of control.

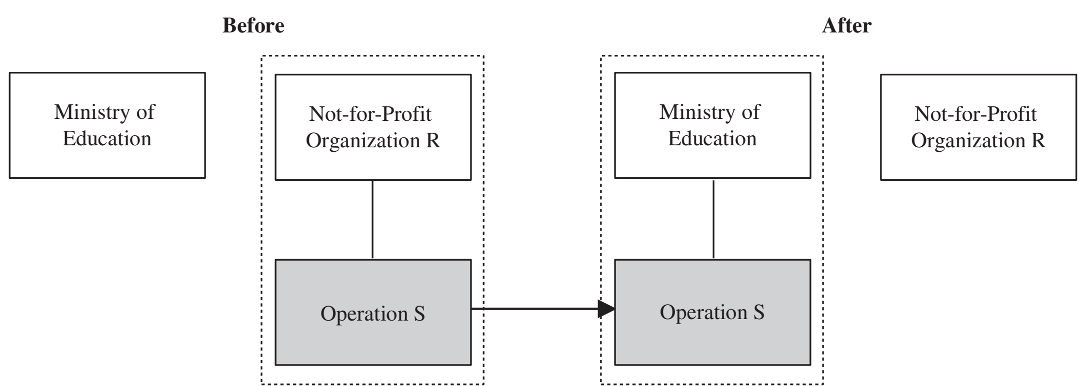
IE118. In considering the indicators relating to consideration, Municipality O notes that the public sector combination includes consideration that is intended to compensate the seller for giving up their entitlement to the net assets of an operation. However, the level of compensation is less than Company P would have accepted voluntarily. Consequently, these indicators provide only weak evidence that the economic substance of the combination is that of an acquisition, and greater reliance is placed on other factors.

IE119. In considering the indicators relating to the decision-making process, Municipality O notes that Company P does not act voluntarily. The fact that Municipality O (a party to the combination) is able to impose the public sector combination on Company P provides evidence that the economic substance of the combination is that of an acquisition.

IE120. Taking all the factors into account, Municipality O classifies the public sector combination as an acquisition.

Scenario 11: Donated Operations

IE121. The following diagram illustrates the receipt of a donated operation by a public sector entity.



IE122. In this scenario, Not-for-Profit Organization R, a charity providing education services, voluntarily transfers Operation S, a school, to the Ministry of Education at no cost. Not-for-Profit Organization R does this because it considers that this will result in improved services to the public, and enable it to meet its objectives.

IE123. The donation of Operation S is a public sector combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question the Ministry of Education considers is whether it has gained control of operations as a result of the combination.

IE124. In this scenario, the Ministry of Education gains:

(a) Power over Operation S;

(b) Exposure, or rights, to variable benefits from its involvement with Operation S; and

(c) The ability to use its power over Operation S to affect the nature or amount of the benefits from its involvement with that operation.

IE125. The Ministry of Education concludes that, as a result of the public sector combination, it has gained control of Operation S. The Ministry of Education considers the guidance in paragraphs 9–14 and AG19–AG50 of IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE126. In considering the economic substance of the public sector combination, the Ministry of Education notes that the combination has commercial substance (even though no price was paid for Operation S), which is suggestive of an acquisition.

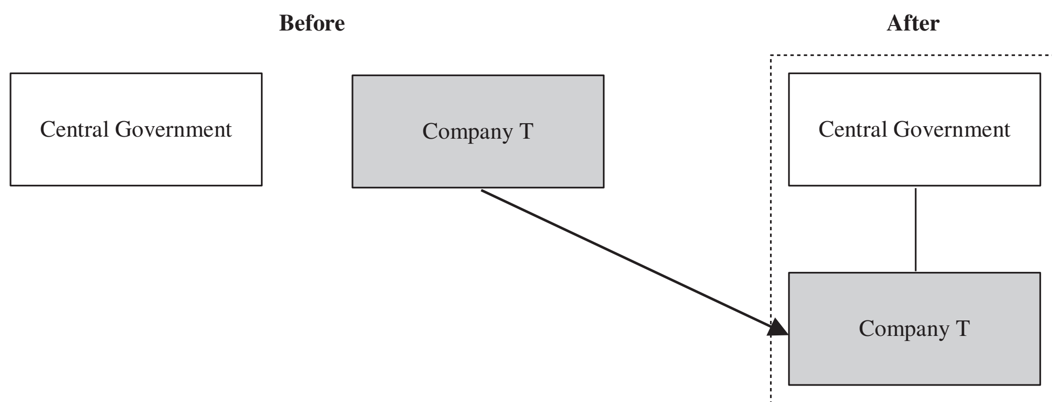
IE127. In considering the indicators relating to consideration, the Ministry of Education notes that the public sector combination does not include the payment of consideration that is intended to compensate the seller for giving up their entitlement to the net assets of an operation. However, the reason for this is that Not-for-Profit Organization R voluntarily surrendered those rights. The situation is similar to that of a bargain purchase. In a bargain purchase, a seller may be willing to accept a price below market value where this meets their needs, for example in enabling a quick sale. With a donated operation, the former owner is willing to transfer the operation for no consideration to their preferred counterparty. In this scenario, Not-for-Profit Organization R is willing to transfer Operation S to the Ministry of Education because this will provide improved services to the public. Consequently, the Ministry of Education concludes that the indicators of consideration do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE128. In considering the indicators relating to the decision-making process, the Ministry of Education notes that the public sector combination is a voluntary combination. Consequently, these indicators do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE129. Taking these factors together, the Ministry of Education concludes that there is no evidence that the economic substance of the combination is that of an amalgamation, and that the public sector combination should, therefore, be classified as an acquisition.

Scenario 12: Nationalization of a Private Sector Entity–Forced Seizure

IE130. The following diagram illustrates the nationalization of a private sector entity by a public sector entity by means of a forced seizure.



IE131. In this scenario, Central Government nationalizes Company T through legislation. Central Government does not pay any consideration to the shareholders of Company T. Following the purchase, Company T is managed as an arms-length, stand-alone entity.

IE132. The nationalization of Company T is a public sector combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question Central Government considers is whether it has gained control of operations as a result of the combination.

IE133. In this scenario, Central Government gains:

(a) Power over Company T;

(b) Exposure, or rights, to variable benefits from its involvement with Company T; and

(c) The ability to use its power over Company T to affect the nature or amount of the benefits from its involvement with Company T.

IE134. Central Government concludes that, as a result of the public sector combination, it has gained control of Company T. Central Government considers the guidance in paragraphs 9–14 and AG19–AG50 of IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE135. In considering the economic substance of the public sector combination, Central Government notes that the combination results in a controlling entity/controlled entity relationship between Central Government and Company T. This is inconsistent with the economic substance of an amalgamation. Central Government also notes that, by depriving the former shareholders of their rights to Company T, the combination has commercial substance, which is suggestive of an acquisition.

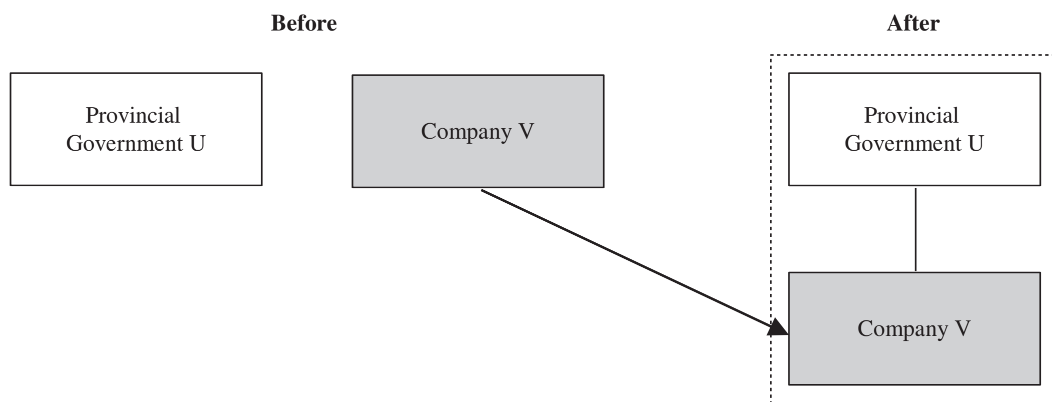
IE136. In considering the indicators relating to consideration, Central Government notes that the public sector combination does not include the payment of consideration that is intended to compensate the seller for giving up their entitlement to the net assets of an operation. However, the former shareholders of Company T have had their entitlements extinguished through compulsion, which provides evidence that the economic substance of the combination is that of an acquisition. Central Government concludes that the indicators relating to consideration do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE137. In considering the indicators relating to the decision-making process, Central Government notes that Company T does not act voluntarily. The fact that Central Government (a party to the combination) is able to impose the public sector combination on Company T provides evidence that the economic substance of the combination is that of an acquisition.

IE138. Taking these factors together, Central Government concludes that there is no evidence that the economic substance of the combination is that of an amalgamation, and that the public sector combination should, therefore, be classified as an acquisition.

Scenario 13: Nationalization of a Private Sector Entity–Bailout

IE139. The following diagram illustrates the nationalization of a private sector entity by a public sector entity by means of a bailout.



IE140. In this scenario, Provincial Government U nationalizes Company V through legislation as a result of a bailout. Prior to the nationalization, Company V was in financial distress. Provincial Government U does not pay any consideration to the shareholders of Company V but does assume Company V's net liabilities. Following the purchase, Company V is managed as an arms-length, stand-alone entity.

IE141. The nationalization of Company V is a public sector combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question Provincial Government U considers is whether it has gained control of operations as a result of the combination.

IE142. In this scenario, Provincial Government U gains:

(a) Power over Company V;

(b) Exposure, or rights, to variable benefits from its involvement with Company V; and

(c) The ability to use its power over Company V to affect the nature or amount of the benefits from its involvement with Company V.

IE143. Provincial Government U concludes that, as a result of the public sector combination, it has gained control of Company V. Provincial Government U considers the guidance in paragraphs 9–14 and AG19–AG50 of IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE144. In considering the economic substance of the public sector combination, Provincial Government U notes that the combination results in a controlling entity/controlled entity relationship between Provincial Government U and Company V. This is inconsistent with the economic substance of an amalgamation. Provincial Government U also notes that, by assuming the net liabilities of Company V, the combination has commercial substance, which is suggestive of an acquisition.

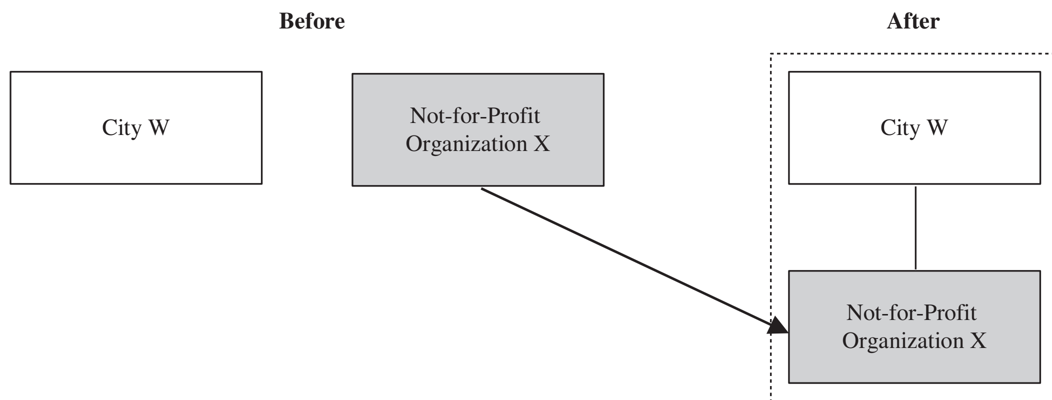
IE145. In considering the indicators relating to consideration, Provincial Government U notes that the public sector combination does not include the payment of consideration that is intended to compensate the seller for giving up their entitlement to the net assets of an operation. However, Company V has net liabilities that are assumed by Provincial Government U as part of the combination. The lack of consideration reflects the fair value of Company V rather than suggesting that the economic substance of the combination is that of an amalgamation. Provincial Government U concludes that the indicators relating to consideration do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE146. In considering the indicators relating to the decision-making process, Provincial Government U notes that Company V does not act voluntarily. The fact that Provincial Government U (a party to the combination) is able to impose the public sector combination on Company V provides evidence that the economic substance of the combination is that of an acquisition.

IE147. Taking these factors together, Provincial Government U concludes that there is no evidence that the economic substance of the combination is that of an amalgamation, and that the public sector combination should, therefore, be classified as an acquisition.

Scenario 14: Nationalization of a Not-For-Profit Organization–Bailout

IE148. The following diagram illustrates the nationalization of a not-for-profit organization by a public sector entity by means of a bailout.



IE149. In this scenario, City W nationalizes Not-for-Profit Organization X (a charity) as a result of a voluntary bailout. Prior to the nationalization, Not-for-Profit Organization X was in financial distress and approached City W for support. City W assumes Not-for-Profit Organization X's net liabilities. Following the purchase, Not-for-Profit Organization X is managed as an arms-length, stand-alone entity.

IE150. The nationalization of Not-for-Profit Organization X is a public sector combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question City W considers is whether it has gained control of operations as a result of the combination.

IE151. In this scenario, City W gains:

(a) Power over Not-for-Profit Organization X;

(b) Exposure, or rights, to variable benefits from its involvement with Not-for-Profit Organization X; and

(c) The ability to use its power over Not-for-Profit Organization X to affect the nature or amount of the benefits from its involvement with Not-for-Profit Organization X.

IE152. City W concludes that, as a result of the public sector combination, it has gained control of Not-for-Profit Organization X. City W considers the guidance in paragraphs 9–14 and AG19–AG50 of IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE153. In considering the economic substance of the public sector combination, City W notes that the combination results in a controlling entity/controlled entity relationship between City W and Not-for-Profit Organization X. This is inconsistent with the economic substance of an amalgamation. City W also notes that, by assuming the net liabilities of Not-for-Profit Organization X, the combination has commercial substance, which is suggestive of an acquisition.

IE154. In considering the indicators relating to consideration, City W notes that the public sector combination does not include the payment of consideration that is intended to compensate the seller for giving up their entitlement to the net assets of an operation. This is because there is no party with an entitlement to the net assets of Not-for-Profit Organization X (i.e., there is no former owner) as the trustees have no entitlement to the net assets. This would usually provide evidence that the economic substance of the combination is that of an amalgamation. However, in this scenario Not-for-Profit Organization

X has net liabilities that are assumed by City W as part of the combination. By assuming the net liabilities, City W relieves the trustees of Not-for-Profit Organization X of the responsibility for settling the liabilities, which is analogous to paying consideration. City W concludes, therefore, that the indicators relating to consideration do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE155. In considering the indicators relating to the decision-making process, City W notes that Not-for-Profit Organization X voluntarily initiated the combination. City W concludes that the indicators relating to decision-making do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE156. Taking these factors together, City W concludes that there is no evidence that the economic substance of the combination is that of an amalgamation, and that the public sector combination should, therefore, be classified as an acquisition.

Accounting for Amalgamations

Eliminating Transactions between the Combining Operations - Loans

Illustrating the Consequences of Applying Paragraphs 22 and AG51–AG52 of IPSAS 40

IE157. The following example illustrates the process for eliminating a loan between two combining operations not under common control.

IE158. On 30 June 20X5 Resulting Entity (RE) is formed by an amalgamation of two municipalities, Combining Operation A (COA) and Combining Operation B (COB). Four years previously, COA had provided COB with a ten year, fixed interest rate loan of CU250. Interest on the loan is payable annually, with the principal repayable on maturity.

IE159. COB has recently experienced financial difficulties, and at the amalgamation date was in arrears on making the interest payments. The carrying amount of the financial liability (the amortized cost of the loan) in its financial statements at the amalgamation date is CU260.

IE160. Because of the arrears and the fact that COB was experiencing financial difficulties, COA had impaired the loan. The carrying amount of the financial asset (the loan) in its financial statements at the amalgamation date is CU200.

IE161. At the amalgamation date, RE eliminates the financial asset received from COA and the financial liability assumed from COB and credits components of net assets/equity with CU60, the difference between the carrying amounts of the financial asset and the financial liability associated with the loan.

Eliminating Transactions between the Combining Operations - Transfers

Illustrating the Consequences of Applying Paragraphs 22 and AG51–AG52 of IPSAS 40

IE162. The following example illustrates the process for eliminating a transfer between two combining operations not under common control.

IE163. On 30 June 20X9, Resulting Entity (RE) is formed by an amalgamation of two government agencies, Combining Operation A (COA) and Combining Operation B (COB). On 1 January 20X9, COA had provided COB with a grant of CU700 to be used in the provision of an agreed number of training courses.

IE164. The grant was subject to a condition that the grant would be returned proportionately to the number of training courses not delivered. At the amalgamation date, COB had delivered half of the agreed number of courses, and recognized a liability of CU350 in respect of its performance obligation, in accordance with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. Based on past experience, COA considered that COB was more likely than not to deliver the training courses. It was therefore not probable that there would be a flow of resources to COA, and COA did not recognize an asset in respect of the grant, but accounted for the full CU700 as an expense.

IE165. At the amalgamation date, the transaction is eliminated. There is no longer an obligation to an external party. The resulting entity does not recognize a liability for the CU350, but instead recognizes this amount in net assets/equity.

Adjusting the Carrying Amounts of the Identifiable Assets and Liabilities of the Combining Operations to Conform to the Resulting Entity's Accounting Policies in an Amalgamation

Illustrating the Consequences of Applying Paragraphs 26–27 and 36 of IPSAS 40

IE166. The following example illustrates the process for adjusting the carrying amounts of the identifiable assets and liabilities of the combining operations to conform to the resulting entity's accounting policies in an amalgamation under common control.

IE167. On 1 October 20X5 RE is formed by an amalgamation of two government departments, COA and COB. COA has previously adopted an accounting policy of measuring property, plant and equipment using the cost model in IPSAS 17, *Property, Plant and Equipment*. COB has previously adopted an accounting policy of measuring property, plant and equipment using the revaluation model in IPSAS 17.

IE168. RE adopts an accounting policy of measuring property, plant and equipment using the revaluation model. RE seeks an independent valuation for the items of property, plant and equipment previously controlled by COA.

IE169. On receiving the independent valuation for the items of property, plant and equipment previously controlled by COA, RE adjusts the carrying amounts of the items of property, plant and equipment as follows, with the corresponding entry being made to components of net assets/equity:

Class of Asset	Carrying Amount (CU)	Valuation (CU)	Adjustment (CU)
Land	17,623	18,410	787
Buildings	35,662	37,140	1,478
Vehicles	1,723	1,605	(118)

IE170. RE also reviews the carrying amounts of the items of property, plant and equipment previously controlled by COB to ensure the amounts are up to date as at 1 October 20X5. The review confirms the carrying amounts of the items of property, plant and equipment previously controlled by COB are up to date and that no adjustment is required.

IE171. RE recognizes the items of property, plant and equipment previously controlled by COB at their carrying amounts. In accordance with paragraph 67 of IPSAS 17, RE will review the residual values and useful lives of the plant and equipment previously controlled by both COA and COB at least at each annual reporting date. If expectations differ from previous estimates, RE will account for these changes as changes in accounting estimates, in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Forgiveness of Amounts of Tax Due in an Amalgamation

Illustrating the Consequences of Accounting for Tax Forgiveness in an Amalgamation by Applying Paragraphs 33–34 and AG57–AG58 of IPSAS 40

IE172. The following example illustrates the accounting for an amalgamation not under common control in which the resulting entity's tax liability is forgiven as part of the terms of the amalgamation.

IE173. On 1 January 20X6 RE is formed by an amalgamation of two public sector entities, COA and COB. The amalgamation is directed by the national government. RE, COA and COB have the same accounting policies; no adjustment to the carrying amounts of the identifiable assets and liabilities of the COA and COB to conform to the resulting entity's accounting policies is required. At the date of the amalgamation, there are no amounts outstanding between COA and COB.

IE174. In its statement of financial position as at 1 January 20X6, RE recognizes and measures the assets and liabilities of COA and COB at their carrying amounts in their respective financial statements as of the amalgamation date:

Statement of Financial Position:	COA (CU)	COB (CU)	RE (CU)
Financial assets	1,205	997	2,202
Inventory	25	42	67
Property, plant and equipment	21,944	18,061	40,005
Identifiable intangible assets	0	3,041	3,041
Financial liabilities	(22,916)	(22,020)	(44,936)
Tax liabilities	(76)	(119)	(195)
Total net assets	182	2	184
Net Assets/Equity	182	2	184

IE175. Suppose that the terms of the amalgamation include the Ministry of Finance (MF) (the tax authority) forgiving RE's tax liability. RE would derecognize the tax liability and make the adjustment to net assets/equity. The statement of financial position as at 1 January 20X6 for RE would be as follows:

Statement of Financial Position:	**RE (CU)**
Financial assets	2,202
Inventory	67
Property, plant and equipment	40,005
Intangible assets	3,041
Financial liabilities	(44,936)
Tax liabilities	0
Total net assets	379
Net Assets/Equity	379

IE176. MF accounts for tax receivable in accordance with IPSAS 23, and would recognize an adjustment for the tax forgiven.

Recognizing and Measuring Components of Net Assets/Equity Arising as a Result of an Amalgamation

Illustrating the Consequences of Applying Paragraphs 37–39 of IPSAS 40

IE177. The following example illustrates the accounting for recognizing and measuring components of net assets/equity in an amalgamation.

IE178. On 1 June 20X4, a new municipality RE is formed by the amalgamation of operations COA and COB relating to two geographical areas of other municipalities, not previously under common control.

IE179. COB has previously performed services for COA for which it was to be paid CU750. Payment was outstanding at the amalgamation date. This transaction formed part of the carrying amount of financial liabilities for COA and part of the carrying amount of financial assets for COB.

IE180. COA has previously adopted an accounting policy of measuring property, plant and equipment using the cost model. COB has previously adopted an accounting policy of measuring property, plant and equipment using the revaluation model. RE has adopted an accounting policy of measuring property, plant and equipment using the revaluation model. RE obtains an independent valuation for the items of property, plant and equipment previously controlled by COA. As a result, it increases its carrying amount for those items of the property, plant and equipment by CU5,750 and makes the corresponding adjustment to components of net assets/equity.

IE181. The carrying amounts of the assets, liabilities and components of net assets/equity transferred are summarized below. Adjustments to eliminate transactions between COA and COB (see paragraph 22), and to conform the carrying amounts to the resulting entity›s accounting policies are also shown.

	COA (CU)	**COB (CU)**	**Elimination Adjustments (CU)**	**Accounting Policy Adjustments (CU)**	**RE Opening Balance (CU)**
Financial Assets	11,248	17,311	(750)		27,809
Inventory	1,072	532			1,604
Property, plant and equipment	5,663	12,171		5,750	23,584
Intangible assets	0	137			137
Financial liabilities	(18,798)	(20,553)	750		(38,601)
Total net assets/ (liabilities)	(815)	9,598		5,750	14,533
Revaluation surplus	0	6,939		5,750	12,689
Accumulated surpluses or deficits	(815)	2,659			1,844
Total net assets/equity	(815)	9,598	0	5,750	14,533

IE182. In accordance with paragraphs 37–39 of IPSAS 40, RE may present net assets/equity as either a single opening balance of CU14,533 or as the separate components shown above.

IE183. The other municipalities that, prior to the amalgamation, controlled COA and COB would derecognize the assets, liabilities and components of net assets/equity transferred to RE in accordance with other IPSASs.

Measurement Period in an Amalgamation

Illustrating the Consequences of Applying Paragraphs 40–44 of IPSAS 40.

IE184. If the initial accounting for an amalgamation is not complete at the end of the financial reporting period in which the amalgamation occurs, paragraph 40 of IPSAS 40 requires the resulting entity to recognize in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the resulting entity recognizes adjustments to the provisional amounts needed to reflect new information obtained about facts and circumstances that existed as of the amalgamation date and, if known, would have affected the measurement of the amounts recognized as of that date. Paragraph 43 of IPSAS 40 requires the resulting entity to recognize such adjustments as if the accounting for the amalgamation had been completed at the amalgamation date. Measurement period adjustments are not included in surplus or deficit.

IE185. Suppose that RE is formed by the amalgamation of COA and COB (two municipalities that were not under common control prior to the amalgamation) on 30 November 20X3. Prior to the amalgamation, COA had an accounting policy of using the revaluation model for measuring land and buildings, whereas COB's accounting policy was to measure land and buildings using the cost model. RE adopts an accounting policy of measuring land and buildings using the revaluation model, and seeks an independent valuation for the land and buildings previously controlled by COB. This valuation was not complete by the time RE authorized for issue its financial statements for the year ended 31 December 20X3. In its 20X3 annual financial statements, RE recognized provisional values for the land and buildings of CU150,000 and CU275,000 respectively. At the amalgamation date, the buildings had a remaining useful life of fifteen years. The land had an indefinite life. Four months after the amalgamation date, RE received the independent valuation, which estimated the amalgamation-date value of the land as CU160,000 and the amalgamation-date value of the buildings as CU365,000.

IE186. In its financial statements for the year ended 31 December 20X4, RE retrospectively adjusts the 20X3 prior year information as follows:

(a) The carrying amount of the land as of 31 December 20X3 is increased by CU10,000. As the land has an indefinite life, no depreciation is charged.

(b) The carrying amount of the buildings as of 31 December 20X3 is increased by CU89,500. That adjustment is measured as the valuation adjustment at the amalgamation date of CU90,000 less the additional depreciation that would have been recognized if the asset's value at the amalgamation date had been recognized from that date (CU500 for one months' depreciation).

(c) An adjustment of CU100,000 is recognized in net assets/equity as of 31 December 20X3.

(d) Depreciation expense for 20X3 is increased by CU500.

IE187. In accordance with paragraph 56 of IPSAS 40, RE discloses:

(a) In its 20X3 financial statements, that the initial accounting for the amalgamation has not been completed because the valuation of land and buildings previously controlled by COB has not yet been received.

(b) In its 20X4 financial statements, the amounts and explanations of the adjustments to the provisional values recognized during the current reporting period. Therefore, RE discloses that the 20X3 comparative information is adjusted retrospectively to increase the value of the land and buildings by CU99,500 (CU100,000 at the amalgamation date), an increase in depreciation expense of CU500 and an increase in net assets/equity of CU100,000.

Subsequent Measurement of a Transfer Received by a Combining Operation on the Basis of Criteria that May Change as a Result of an Amalgamation

Illustrating the Consequences of Applying the Requirements in Paragraphs 48 and AG61–AG63 of IPSAS 40.

IE188. The following example illustrates the subsequent accounting for a transfer received by a combining operation on the basis of criteria that may change as a result of an amalgamation.

IE189. On 1 January 20X3, a national government provides an annual grant to those municipalities where the average household income is below a threshold. On 1 June 20X3, RE, a new municipality, is formed by the amalgamation of two existing municipalities, COA and COB. COA had previously received a grant of CU1,000, based on its average household income. COB has received no grant as its average household income was above the threshold.

IE190. Following the amalgamation on 1 June 20X3, the average household income of RE is above the threshold that the government had set when allocating grants.

IE191. On 1 July 20X3, the national government requires RE to repay a portion (CU200) of the grant previously paid to COA. RE recognizes a liability and an expense of CU200 on 1 July 20X3.

Disclosure Requirements Relating to Amalgamations

Illustrating the Consequences of Applying the Disclosure Requirements in Paragraphs 53–57 of IPSAS 40.

IE192. The following example illustrates some of the disclosure requirements relating to amalgamations of IPSAS 40; it is not based on an actual transaction. The example assumes that RE is a newly created municipality formed by amalgamating the former municipalities COA and COB. The illustration presents the disclosures in a tabular format that refers to the specific disclosure requirements illustrated. An actual footnote might present many of the disclosures illustrated in a simple narrative format.

Paragraph reference		
54(a)–(c)	On 30 June 20X2 RE was formed by an amalgamation of the former municipalities COA and COB. Neither COA nor COB gained control of RE in the amalgamation. The amalgamation was mutually agreed by COA and COB, and enacted by the Government through legislation. The amalgamation aims to reduce costs through economies of scale, and to provide improved services to residents.	
54(d)	**Amounts recognized for each major class of assets and liabilities transferred as at 30 June 20X2**	
		CU
	Financial assets	1,701
	Inventory	5
	Property, plant and equipment	74,656
	Intangible assets	42
	Financial liabilities	(2,001)
	Total net assets	74,403
54(e)	The following adjustments have been made to the carrying amounts of assets and liabilities recorded by COA and COB as at 30 June 20X2 prior to the amalgamation:	

Paragraph reference		**Original Amount (CU)**	**Adjustment (CU)**	**Revised Amount (CU)**
54(e)(i)	Restatement of financial assets reorded by COA to eliminate transactions with COB	822	(25)	797
54(e)(i)	Restatement of financial liabilities recorded by COB to eliminate transactions with COA	(1,093)	25	(1,068)
54(e)(ii)	Restatement of property plant and equipment recorded by COA to measure the items using the revaluation model	12,116	17,954	30,070

54(f) **Amounts recognized in Net assets/equity as at 30 June 20X2**

	COA (CU)	COB (CU)	Adjustment (CU)	RE (CU)
Revaluation surplus	0	18,332	17,954	36,286
Accumulated surpluses or deficits	12,047	26,070	0	38,117
Total net assets/equity	12,047	44,402	17,954	74,403

54(h) At the time these financial statements were authorized for issue, the last reporting date for COA and COB was 31 December 20X1. The revenue and expense, and surplus or deficit for COA and COB from 1 January 20X2 to the amalgamation date (30 June 20X2), and the amounts reported by COA and COB for each major class of assets and liabilities, and for components of net assets/equity, is shown below:

		COA (CU)	COB (CU)
54(h)(i)	**Revenue**		
	Property taxes	45,213	70,369
	Revenue from exchange transactions	2,681	25,377
	Transfers from other government entities	32,615	19,345
	Total revenue	80,509	115,091
54(h)(i)	**Expenses**		
	Wages, salaries and employee benefits	(51,263)	(68,549)
	Grants and other transfer payments	(18,611)	(26,445)
	Supplies and consumables used	(7,545)	(13,391)
	Depreciation expense	(677)	(2,598)
	Impairment of property, plant and equipment	(17)	(33)
	Finance costs	(2)	(3)
	Total expenses	(78,115)	(111,019)
54(h)(i)	**Surplus or (deficit) for the period 1 January 20X2 to 30 June 20X2**	2,394	4,072
54(h)(ii)	**Assets as at 30 June 20X2**		
	Financial assets	822	904
	Inventory	0	5
	Property, plant and equipment	12,116	44,586
	Intangible assets	42	0
	Total Assets	12,980	45,495
54(h)(ii)	**Liabilities as at 30 June 20X2**		
	Financial liabilities	(933)	(1,093)

	Total liabilities	(933)	(1,093)
54(h)(iii)	**Net assets as at 30 June 20X2**	12,047	44,402
	Net assets/equity as at 30 June 20X2		
	Revaluation surplus	0	18,332
	Accumulated surpluses or deficits	12,047	26,070
	Total net assets/equity as at 30 June 20X2	12,047	44,402

In considering the disclosures related to an amalgamation, an entity may find it helpful to refer to the discussion of materiality in IPSAS 1, *Presentation of Financial Statements*.

Accounting for Acquisitions

Reverse Acquisitions

Illustrating the Consequences of Recognizing a Reverse Acquisition by Applying Paragraphs AG66–AG71 of IPSAS 40

IE193. This example illustrates the accounting for a reverse acquisition in which Entity B, the legal controlled entity, acquires Entity A, the entity issuing equity instruments and therefore the legal controlling entity, in a reverse acquisition on 30 September 20X6. This example ignores the accounting for any income tax effects.

IE194. The statements of financial position of Entity A and Entity B immediately before the acquisition are:

	Entity A (legal controlling entity, accounting acquired operation) CU	**Entity B (legal controlled entity, accounting acquirer) CU**
Current assets	500	700
Non-current assets	1,300	3,000
Total assets	1,800	3,700
Current liabilities	300	600
Non-current liabilities	400	1,100
Total liabilities	700	1,700
Shareholders' equity		
Accumulated surplus or deficit	800	1,400
Issued equity		
100 ordinary shares	300	
60 ordinary shares		600
Total shareholders' equity	1,100	2,000
Total liabilities and shareholders' equity	1,800	3,700

IE195. This example also uses the following information:

(a) On 30 September 20X6 Entity A issues 2.5 shares in exchange for each ordinary share of Entity B. Entity B's sole shareholder, a government, exchanges its shares in Entity B. Therefore, Entity A issues 150 ordinary shares in exchange for all 60 ordinary shares of Entity B.

(b) The fair value of each ordinary share of Entity B at 30 September 20X6 is CU40. The quoted market price of Entity A's ordinary shares at that date is CU16.

(c) The fair values of Entity A's identifiable assets and liabilities at 30 September 20X6 are the same as their carrying amounts, except that the fair value of Entity A's non-current assets at 30 September 20X6 is CU1,500.

Calculating the Fair Value of the Consideration Transferred

IE196. As a result of Entity A (legal controlling entity, accounting acquired operation) issuing 150 ordinary shares, Entity B's shareholder (the government) owns 60 percent of the issued shares of the combined entity (i.e., 150 of 250 issued shares). The remaining 40 percent are owned by Entity A's shareholders. If the acquisition had taken the form of Entity B issuing additional ordinary shares to Entity A's shareholders in exchange for their ordinary shares in Entity A, Entity B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. Entity B's shareholder (the government) would then own 60 of the 100 issued shares of Entity B—60 percent of the combined entity. As a result, the fair value of the consideration effectively transferred by Entity B and the group's interest in Entity A is CU1,600 (40 shares with a fair value per share of CU40).

IE197. The fair value of the consideration effectively transferred should be based on the most reliable measure. In this example, the quoted price of Entity A's shares in the principal (or most advantageous) market for the shares provides a more reliable basis for measuring the consideration effectively transferred than the fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A's shares—100 shares with a fair value per share of CU16.

Measuring Goodwill

IE198. Goodwill is measured as the excess of the fair value of the consideration effectively transferred (the group's interest in Entity A) over the net amount of Entity A's recognized identifiable assets and liabilities, as follows:

	CU	**CU**
Consideration effectively transferred		1,600
Net recognized values of Entity A's identifiable assets and liabilities		
Current assets	500	
Non-current assets	1,500	
Current liabilities	(300)	
Non-current liabilities	(400)	(1,300)
Goodwill		300

Consolidated Statement of Financial Position at 30 September 20X6

IE199. The consolidated statement of financial position immediately after the acquisition is:

	CU
Current assets [CU700 + CU500]	1,200
Non-current assets [CU3,000 + CU1,500]	4,500
Goodwill	300
Total assets	6,000
Current liabilities [CU600 + CU300]	900
Non-current liabilities [CU1,100 + CU400]	1,500
Total liabilities	2,400
Shareholders' equity	
Accumulated surplus or deficit	1,400
Issued equity	
250 ordinary shares [CU600 + CU1,600]	2,200
Total shareholders' equity	3,600
Total liabilities and shareholders' equity	6,000

IE200. The amount recognized as issued equity interests in the consolidated financial statements (CU2,200) is determined by adding the issued equity of the legal controlled entity immediately before the acquisition (CU600) and the fair value of the consideration effectively transferred (CU1,600). However, the equity structure appearing in the consolidated financial

statements (i.e., the number and type of equity interests issued) must reflect the equity structure of the legal controlling entity, including the equity interests issued by the legal controlling entity to effect the combination.

Non-Controlling Interest

IE201. Assume the same facts as above, except that Entity B has more than one shareholder, and that only 56 of Entity B's 60 ordinary shares are exchanged. Because Entity A issues 2.5 shares in exchange for each ordinary share of Entity B, Entity A issues only 140 (rather than 150) shares. As a result, Entity B's shareholders own 58.3 percent of the issued shares of the combined entity (140 of 240 issued shares). The fair value of the consideration transferred for Entity A, the accounting acquired operation, is calculated by assuming that the combination had been effected by Entity B issuing additional ordinary shares to the shareholders of Entity A in exchange for their ordinary shares in Entity A. That is because Entity B is the accounting acquirer, and paragraph AG67 of IPSAS 40 requires the acquirer to measure the consideration exchanged for the accounting acquired operation.

IE202. In calculating the number of shares that Entity B would have had to issue, the non-controlling interest is excluded from the calculation. The majority shareholder (the government) owns 56 shares of Entity B. For that to represent a 58.3 percent equity interest, Entity B would have had to issue an additional 40 shares. The majority shareholder (the government) would then own 56 of the 96 issued shares of Entity B and, therefore, 58.3 percent of the combined entity. As a result, the fair value of the consideration transferred for Entity A, the accounting acquired operation, is CU1,600 (i.e., 40 shares, each with a fair value of CU40). That is the same amount as when Entity B's sole shareholder tenders all 60 of its ordinary shares for exchange. The recognized amount of the group's interest in Entity A, the accounting acquired operation, does not change if some of Entity B's shareholders do not participate in the exchange.

IE203. The non-controlling interest is represented by the four shares of the total 60 shares of Entity B that are not exchanged for shares of Entity A. Therefore, the non-controlling interest is 6.7 percent. The non-controlling interest reflects the proportionate interest of the non-controlling shareholders in the pre-combination carrying amounts of the net assets of Entity B, the legal controlled entity. Therefore, the consolidated statement of financial position is adjusted to show a non-controlling interest of 6.7 percent of the pre-combination carrying amounts of Entity B's net assets (i.e., CU134 or 6.7 percent of CU2,000).

IE204. The consolidated statement of financial position at 30 September 20X6, reflecting the non-controlling interest, is as follows:

	CU
Current assets [CU700 + CU500]	1,200
Non-current assets [CU3,000 + CU1,500]	4,500
Goodwill	300
Total assets	6,000
Current liabilities [CU600 + CU300]	900
Non-current liabilities [CU1,100 + CU400]	1,500
Total liabilities	2,400
Shareholders' equity	
Accumulated surplus or deficit [CU1,400 × 93.3 percent]	1,306
Issued equity	
240 ordinary shares [CU560 + CU1,600]	2,160
Non-controlling interest	134
Total shareholders' equity	3,600
Total liabilities and shareholders' equity	6,000

IE205. The non-controlling interest of CU134 has two components. The first component is the reclassification of the non-controlling interest's share of the accounting acquirer's retained earnings immediately before the acquisition (CU1,400 × 6.7 percent or CU93.80). The second component represents the reclassification of the non-controlling interest's share of the accounting acquirer's issued equity (CU600 × 6.7 percent or CU40.20).

Identifiable Intangible Assets in an Acquisition

Illustrating the Consequences of Applying Paragraphs 64–68 and AG75–AG84 of IPSAS 40

IE206. The following are examples of identifiable intangible assets acquired in an acquisition. Some of the examples may have characteristics of assets other than intangible assets. The acquirer should account for those assets in accordance with their substance. The examples are not intended to be all-inclusive.

IE207. Intangible assets identified as having a 'binding arrangement' basis are those that arise from binding arrangements (including rights from contracts or other legal rights). Those designated as having a 'no binding arrangement' basis do not arise from binding arrangements but are separable. Intangible assets identified as having a binding arrangement basis might also be separable but separability is not a necessary condition for an asset to meet the binding arrangement criterion.

Marketing-Related Intangible Assets

IE208. Marketing-related intangible assets are used primarily in the marketing or promotion of products or services. Examples of marketing-related intangible assets are:

Class	**Basis**
Trademarks, trade names, service marks, collective marks and certification marks	Binding arrangement
Trade dress (unique color, shape or package design)	Binding arrangement
Newspaper mastheads	Binding arrangement
Internet domain names	Binding arrangement
Non-competition agreements	Binding arrangement

Trademarks, Trade Names, Service Marks, Collective Marks and Certification Marks

IE209. Trademarks are words, names, symbols or other devices used in trade to indicate the source of a product and to distinguish it from the products of others. A service mark identifies and distinguishes the source of a service rather than a product. Collective marks identify the goods or services of members of a group. Certification marks certify the geographical origin or other characteristics of a good or service.

IE210. Trademarks, trade names, service marks, collective marks and certification marks may be protected legally through registration with governmental agencies, continuous use in commerce or by other means. If it is protected legally through registration or other means, a trademark or other mark acquired in an acquisition is an intangible asset that meets the binding arrangement criterion. Otherwise, a trademark or other mark acquired in an acquisition can be recognized separately from goodwill if the separability criterion is met, which normally it would be.

IE211. The terms *brand* and *brand name*, often used as synonyms for trademarks and other marks, are general marketing terms that typically refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise. IPSAS 40 does not preclude an entity from recognizing, as a single asset separately from goodwill, a group of complementary intangible assets commonly referred to as a brand if the assets that make up that group have similar useful lives.

Internet Domain Names

IE212. An Internet domain name is a unique alphanumeric name that is used to identify a particular numeric Internet address. Registration of a domain name creates an association between that name and a designated computer on the Internet for the period of the registration. Those registrations are renewable. A registered domain name acquired in an acquisition meets the binding arrangement criterion.

Service User or Customer-Related Intangible Assets

IE213. Examples of service user or customer-related intangible assets are:

Class	**Basis**
Lists of users of a service	No binding arrangement
Order or production backlog	Binding arrangement
Customer binding arrangements and the related customer relationships	Binding arrangement
Customer relationships arising through means other than binding arrangements	No binding arrangement

Lists of Users of a Service

IE214. A list of users of a service consists of information about service users, such as their names and contact information. A list of users of a service also may be in the form of a database that includes other information about the users, such as their service use histories and demographic information. A list of users of a service does not usually arise from a binding arrangement (including rights from contracts or other legal rights). However, lists of users of a service are often leased or exchanged. Therefore, a list of users of a service acquired in an acquisition normally meets the separability criterion.

Order or Production Backlog

IE215. An order or production backlog arises from binding arrangements such as purchase or sales orders. An order or production backlog acquired in an acquisition meets the binding arrangement criterion even if the purchase or sales orders can be cancelled.

Customer Binding Arrangements and the Related Customer Relationships

IE216. If an entity establishes relationships with its customers through binding arrangements, those customer relationships arise from binding arrangement rights. Therefore, customer binding arrangements and the related customer relationships acquired in an acquisition meet the binding arrangement criterion, even if confidentiality or other terms of the binding arrangement prohibit the sale or transfer of a binding arrangement separately from the acquired operation.

IE217. A customer binding arrangement and the related customer relationship may represent two distinct intangible assets. Both the useful lives and the pattern in which the economic benefits of the two assets are consumed may differ.

IE218. A customer relationship exists between an entity and its customer if (a) the entity has information about the customer and has regular contact with the customer and (b) the customer has the ability to make direct contact with the entity. Customer relationships meet the binding arrangement criterion if an entity has a practice of establishing binding arrangements with its customers, regardless of whether a binding arrangement exists at the acquisition date. Customer relationships may also arise through means other than binding arrangements, such as through regular contact by sales or service representatives.

IE219. As noted in paragraph IE215, an order or a production backlog arises from binding arrangements such as purchase or sales orders and is therefore considered a binding arrangement right. Consequently, if an entity has relationships with its customers through these types of binding arrangements, the customer relationships also arise from binding arrangement rights and therefore meet the binding arrangement criterion.

Examples

IE220. The following examples illustrate the recognition of customer binding arrangement and customer relationship intangible assets acquired in an acquisition.

(a) Acquirer Entity (AE) acquires Target Entity (TE) in an acquisition on 31 December 20X5. TE has a five-year agreement to supply goods to Customer. Both TE and AE believe that Customer will renew the agreement at the end of the current binding arrangement. The agreement is not separable.

The agreement, whether cancellable or not, meets the binding arrangement criterion. Additionally, because TE establishes its relationship with Customer through a binding arrangement, not only the agreement itself but also TE's customer relationship with Customer meet the binding arrangement criterion.

(b) AE acquires TE in an acquisition on 31 December 20X5. TE manufactures goods in two distinct lines of business: sporting goods and electronics. Customer purchases both sporting goods and electronics from TE. TE has a binding arrangement with Customer to be its exclusive provider of sporting goods but has no binding arrangement for the supply of electronics to Customer. Both TE and AE believe that only one overall customer relationship exists between TE and Customer.

The binding arrangement to be Customer's exclusive supplier of sporting goods, whether cancellable or not, meets the binding arrangement criterion. Additionally, because TE establishes its relationship with Customer through a binding arrangement, the customer relationship with Customer meets the binding arrangement criterion. Because TE has only one customer relationship with Customer, the fair value of that relationship incorporates assumptions about TE's relationship with Customer related to both sporting goods and electronics. However, if AE determines that the customer relationships with Customer for sporting goods and for electronics are separate from each other, AE would assess whether the customer relationship for electronics meets the separability criterion for identification as an intangible asset.

(c) AE acquires TE in an acquisition on 31 December 20X5. TE does business with its customers solely through purchase and sales orders. At 31 December 20X5, TE has a backlog of customer purchase orders from 60 percent of its customers, all of whom are recurring customers. The other 40 percent of TE's customers are also recurring customers. However, as of 31 December 20X5, TE has no open purchase orders or other binding arrangements with those customers.

Regardless of whether they are cancellable or not, the purchase orders from 60 percent of TE's customers meet the binding arrangement criterion. Additionally, because TE has established its relationship with 60 percent of its customers through binding arrangements, not only the purchase orders but also TE's customer relationships meet the binding arrangement criterion. Because TE has a practice of establishing binding arrangements with the remaining 40 percent of its customers, its relationship with those customers also arises through binding arrangement rights and therefore meets the binding arrangement criterion even though TE does not have binding arrangements with those customers at 31 December 20X5.

(d) AE acquires TE, an insurer, in an acquisition on 31 December 20X5. TE has a portfolio of one-year motor insurance contracts that are cancellable by policyholders.

Because TE establishes its relationships with policyholders through insurance contracts, the customer relationship with policyholders meets the binding arrangement criterion. IPSAS 26, *Impairment of Cash-Generating Assets* and IPSAS 31, *Intangible Assets* apply to the customer relationship intangible asset.

Customer Relationships Arising through Means Other than Binding Arrangements

IE221. A customer relationship acquired in an acquisition that does not arise from a binding arrangement may nevertheless be identifiable because the relationship is separable. Exchange transactions for the same asset or a similar asset that indicate that other entities have sold or otherwise transferred a particular type of customer relationship arising through means other than binding arrangements would provide evidence that the relationship is separable.

Artistic-Related Intangible Assets

IE222. Examples of artistic-related intangible assets are:

Class	**Basis**
Plays, operas and ballets	Binding arrangement
Books, magazines, newspapers and other literary works	Binding arrangement
Musical works such as compositions, song lyrics and advertising jingles	Binding arrangement
Pictures and photographs	Binding arrangement
Video and audio-visual material, including motion pictures or films, music videos and television programs	Binding arrangement

IE223. Artistic-related assets acquired in an acquisition are identifiable if they arise from binding arrangements (including rights from contracts) or legal rights such as those provided by copyright. The holder can transfer a copyright, either in whole through an assignment or in part through a licensing agreement. An acquirer is not precluded from recognizing a copyright intangible asset and any related assignments or license agreements as a single asset, provided they have similar useful lives.

Binding Arrangement-Based Intangible Assets

IE224. Binding arrangement-based intangible assets represent the value of rights that arise from binding arrangements. Binding arrangements with customers are one type of binding arrangement-based intangible asset. If the terms of a binding arrangement give rise to a liability (for example, if the terms of a binding arrangement with a customer are unfavorable relative to market terms), the acquirer recognizes it as a liability assumed in the acquisition. Examples of binding arrangement-based intangible assets are:

Class	**Basis**
Licensing, royalty and standstill agreements	Binding arrangement
Advertising, construction, management, service or supply binding arrangements	Binding arrangement
Construction permits	Binding arrangement
Franchise agreements	Binding arrangement

Class	Basis
Operating and broadcast rights	Binding arrangement
Servicing binding arrangements, such as mortgage servicing binding arrangements	Binding arrangement
Binding arrangements for employment	Binding arrangement
Use rights, such as drilling, water, air, timber cutting and route authorities	Binding arrangement

Servicing Binding Arrangements, Such as Mortgage Servicing Binding Arrangements

IE225. Binding arrangements to service financial assets are one type of binding arrangement-based intangible asset. Although servicing is inherent in all financial assets, it becomes a distinct asset (or liability) by one of the following:

(a) When separated in the binding arrangement from the underlying financial asset by sale or securitization of the assets with servicing retained;

(b) Through the separate purchase and assumption of the servicing.

IE226. If mortgage loans, credit card receivables or other financial assets are acquired in an acquisition with servicing retained, the inherent servicing rights are not a separate intangible asset because the fair value of those servicing rights is included in the measurement of the fair value of the acquired financial asset.

Binding Arrangements for Employment

IE227. Binding arrangements for employment that are beneficial binding arrangements from the perspective of the employer because the pricing of those binding arrangements is favorable relative to market terms are one type of binding arrangement-based intangible asset.

Use Rights

IE228. Use rights include rights for drilling, water, air, timber cutting and route authorities. Some use rights are binding arrangement-based intangible assets to be accounted for separately from goodwill. Other use rights may have characteristics of tangible assets rather than of intangible assets. An acquirer should account for use rights on the basis of their nature.

Technology-Based Intangible Assets

IE229. Examples of technology-based intangible assets are:

Class	Basis
Patented technology	Binding arrangement
Computer software and mask works	Binding arrangement
Unpatented technology	No binding arrangement
Databases, including title plants	No binding arrangement
Trade secrets, such as secret formulas, processes and recipes	Binding arrangement

Computer Software and Mask Works

IE230. Computer software and program formats acquired in an acquisition that are protected legally, such as by patent or copyright, meet the binding arrangement criterion for identification as intangible assets.

IE231. Mask works are software permanently stored on a read-only memory chip as a series of stencils or integrated circuitry. Mask works may have legal protection. Mask works with legal protection that are acquired in an acquisition meet the binding arrangement criterion for identification as intangible assets.

Databases, Including Title Plants

IE232. Databases are collections of information, often stored in electronic form (such as on computer disks or files). A database that includes original works of authorship may be entitled to copyright protection. A database acquired in an acquisition and protected by copyright meets the binding arrangement criterion. However, a database typically includes information created as a consequence of an entity's normal operations, such as lists of service users, or specialized information, such as scientific data or credit information. Databases that are not protected by copyright can be, and often are, exchanged, licensed or leased to others in their entirety or in part. Therefore, even if the future economic benefits from a database do not arise from legal rights, a database acquired in an acquisition meets the separability criterion.

IE233. Title plants constitute a historical record of all matters affecting title to parcels of land in a particular geographical area. Title plant assets are bought and sold, either in whole or in part, in exchange transactions or are licensed. Therefore, title plant assets acquired in an acquisition meet the separability criterion.

Trade Secrets, Such as Secret Formulas, Processes and Recipes

IE234. A trade secret is 'information, including a formula, pattern, recipe, compilation, program, device, method, technique, or process that (a) derives independent economic value, actual or potential, from not being generally known and (b) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.'[3] If the future economic benefits from a trade secret acquired in an acquisition are legally protected, that asset meets the binding arrangement criterion. Otherwise, trade secrets acquired in an acquisition are identifiable only if the separability criterion is met, which is likely to be the case.

Measurement of Non-Controlling Interest (NCI) in an Acquisition

Illustrating the Consequences of Applying Paragraph 73 of IPSAS 40.

IE235. The following examples illustrate the measurement of components of NCI at the acquisition date in an acquisition.

Measurement of NCI Including Preference Shares

IE236. TE has issued 100 preference shares, which are classified as equity. The preference shares have a nominal value of CU1 each. The preference shares give their holders a right to a preferential dividend in priority to the payment of any dividend to the holders of ordinary shares. Upon liquidation of TE, the holders of the preference shares are entitled to receive out of the assets available for distribution the amount of CU1 per share in priority to the holders of ordinary shares. The holders of the preference shares do not have any further rights on liquidation.

IE237. AE acquires all ordinary shares of TE. The transaction gives AE control of TE, and an analysis of the economic substance of the combination using the guidance in paragraphs 9–14 and AG19–AG50 of IPSAS 40 confirms the transaction is an acquisition. The acquisition-date fair value of the preference shares is CU120.

IE238. Paragraph 73 of IPSAS 40 states that for each acquisition, the acquirer shall measure at the acquisition date components of non-controlling interest in the acquired operation that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either fair value or the present ownership instruments' proportionate share in the acquired operation's recognized amounts of the identifiable net assets. All other components of non-controlling interest must be measured at their acquisition-date fair value, unless another measurement basis is required by IPSASs.

IE239. The non-controlling interests that relate to TE's preference shares do not qualify for the measurement choice in paragraph 73 of IPSAS 40 because they do not entitle their holders to a proportionate share of the entity's net assets in the event of liquidation. The acquirer measures the preference shares at their acquisition-date fair value of CU120.

First Variation

IE240. Suppose that upon liquidation of TE, the preference shares entitle their holders to receive a proportionate share of the assets available for distribution. The holders of the preference shares have equal right and ranking to the holders of ordinary shares in the event of liquidation. Assume that the acquisition-date fair value of the preference shares is now CU160 and that the proportionate share of TE's recognized amounts of the identifiable net assets that is attributable to the preference shares is CU140.

IE241. The preference shares qualify for the measurement choice in paragraph 73 of IPSAS 40. AE can choose to measure the preference shares either at their acquisition-date fair value of CU160 or at their proportionate share in the acquired operation's recognized amounts of the identifiable net assets of CU140.

Second Variation

IE242. Suppose also that TE has issued share options as remuneration to its employees. The share options are classified as equity and are vested at the acquisition date. They do not represent present ownership interest and do not entitle their holders to a proportionate share of TE's net assets in the event of liquidation. The fair value of the share options in accordance with the

[3] Melvin Simensky and Lanning Bryer, The New Role of Intellectual Property in Commercial Transactions (New York: John Wiley & Sons, 1998), page 293.

relevant international or national accounting standard dealing with share-based payments at the acquisition date is CU200. The share options do not expire on the acquisition date and AE does not replace them.

IE243. Paragraph 73 of IPSAS 40 requires such share options to be measured at their acquisition-date fair value, unless another measurement basis is required by IPSASs. Paragraph 84 of IPSAS 40 states that the acquirer shall measure an equity instrument related to share-based payment transactions of the acquired operation in accordance with the relevant international or national accounting standard dealing with share-based payments.

IE244. The acquirer measures the non-controlling interests that are related to the share options at their fair value of CU200.

Forgiveness of Amounts of Tax Due in an Acquisition

Illustrating the Consequences of Accounting for Tax Forgiveness in an Acquisition by Applying Paragraphs 78–79 and AG85–AG87 of IPSAS 40

IE245. The following example illustrates the accounting for an acquisition in which part of the acquired operation's tax liability is forgiven as part of the terms of the acquisition.

IE246. On 1 January 20X4 AE, a government ministry acting on behalf of the government, acquires TE, a private entity in exchange for cash of CU575. As a result of the acquisition, AE expects to reduce costs through economies of scale. The fair value of the assets acquired and liabilities assumed are as follows:

Assets acquired and liabilities assumed:	**CU**
Financial assets	265
Inventory	5
Property, plant and equipment	640
Identifiable intangible assets	12
Financial liabilities	(320)
Tax liabilities	(40)
Total net assets	562

IE247. AE recognizes goodwill of CU13, the difference between the price paid to acquire TE (CU575) and the net assets of TE (CU562).

IE248. Suppose that as part of the terms of the acquisition, the government requires MF (the tax authority) to forgive 50 percent of TE's tax liability. The fair value of the assets acquired and liabilities assumed would now be as follows:

Assets acquired and liabilities assumed:	**CU**
Financial assets	265
Inventory	5
Property, plant and equipment	640
Identifiable intangible assets	12
Financial liabilities	(320)
Tax liabilities	(20)
Total net assets	582

IE249. AE recognizes a gain of CU7, the difference between the price paid to acquire TE (CU575) and the net assets of TE (CU582). AE would account for the remaining tax liability in accordance with the relevant international or national accounting standard dealing with income taxes.

IE250. MF accounts for tax receivable in accordance with IPSAS 23, and would recognize an adjustment for the tax forgiven.

Gain on a Bargain Purchase in an Acquisition

Illustrating the Consequences of Recognizing and Measuring a Gain from a Bargain Purchase in an Acquisition by Applying Paragraphs 85–90 of IPSAS 40

IE251. The following example illustrates the accounting for an acquisition in which a gain on a bargain purchase is recognized.

IE252. On 1 January 20X5 AE acquires 80 percent of the equity interests of TE, a private entity, in exchange for cash of CU150. Because the former owners of TE needed to dispose of their investments in TE by a specified date, they did not have sufficient time to market TE to multiple potential buyers. The management of AE initially measures the separately recognizable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirements of IPSAS 40. The identifiable assets are measured at CU250 and the liabilities assumed are measured at CU50. AE engages an independent consultant, who determines that the fair value of the 20 percent non-controlling interest in TE is CU42.

IE253. The amount of TE's identifiable net assets (CU200, calculated as CU250 – CU50) exceeds the fair value of the consideration transferred plus the fair value of the non-controlling interest in TE. Therefore, AE reviews the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the non-controlling interest in TE and the consideration transferred. After that review, AE decides that the procedures and resulting measures were appropriate. AE measures the gain on its purchase of the 80 percent interest as follows:

			CU
Amount of the identifiable net assets acquired (CU250 – CU50)			200
Less:	Fair value of the consideration transferred for AE's 80 percent interest in TE; plus	150	
	Fair value of non-controlling interest in TE	42	
			192
Gain on bargain purchase of 80 percent interest			8

IE254. AE would record its acquisition of TE in its consolidated financial statements as follows:

	CU	**CU**
Dr Identifiable assets acquired	250	
Cr Cash		150
Cr Liabilities assumed		50
Cr Gain on the bargain purchase		8
Cr Equity—non-controlling interest in TE		42

IE255. If the acquirer chose to measure the non-controlling interest in TE on the basis of its proportionate interest in the identifiable net assets of the acquired operation, the recognized amount of the non-controlling interest would be CU40 (CU200 × 0.20). The gain on the bargain purchase then would be CU10 (CU200 – (CU150 + CU40)).

Measurement Period in an Acquisition

Illustrating the Consequences of Applying Paragraphs 103–108 of IPSAS 40.

IE256. If the initial accounting for an acquisition is not complete at the end of the financial reporting period in which the combination occurs, paragraph 103 of IPSAS 40 requires the acquirer to recognize in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer recognizes adjustments to the provisional amounts needed to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognized as of that date. Paragraph 107 of IPSAS 40 requires the acquirer to recognize such adjustments as if the accounting for the acquisition had been completed at the acquisition date. Measurement period adjustments are not included in surplus or deficit.

IE257. Suppose that AE acquires TE on 30 September 20X7. AE seeks an independent valuation for an item of property, plant and equipment acquired in the combination, and the valuation was not complete by the time AE authorized for issue its financial statements for the year ended 31 December 20X7. In its 20X7 annual financial statements, AE recognized a provisional fair value for the asset of CU30,000. At the acquisition date, the item of property, plant and equipment had a remaining useful life of five years. Five months after the acquisition date, AE received the independent valuation, which estimated the asset's acquisition-date fair value as CU40,000.

IE258. In its financial statements for the year ended 31 December 20X8, AE retrospectively adjusts the 20X7 prior year information as follows:

(a) The carrying amount of property, plant and equipment as of 31 December 20X7 is increased by CU9,500. That adjustment is measured as the fair value adjustment at the acquisition date of CU10,000 less the additional depreciation that would have been recognized if the asset's fair value at the acquisition date had been recognized from that date (CU500 for three months' depreciation).

(b) The carrying amount of goodwill as of 31 December 20X7 is decreased by CU10,000.

(c) Depreciation expense for 20X7 is increased by CU500.

IE259. In accordance with paragraph 124 of IPSAS 40, AE discloses:

(a) In its 20X7 financial statements, that the initial accounting for the acquisition has not been completed because the valuation of property, plant and equipment has not yet been received.

(b) In its 20X8 financial statements, the amounts and explanations of the adjustments to the provisional values recognized during the current reporting period. Therefore, AE discloses that the 20X7 comparative information is adjusted retrospectively to increase the fair value of the item of property, plant and equipment at the acquisition date by CU9,500, offset by a decrease to goodwill of CU10,000 and an increase in depreciation expense of CU500.

Determining what is Part of the Acquisition Transaction

Settlement of a Pre-Existing Relationship – loan

Illustrating the Consequences of Applying Paragraphs 109–110 and AG98–AG101 of IPSAS 40.

IE260. AE provides TE with a five year, fixed rate loan of CU100. Interest is payable quarterly, with the principal repaid on maturity. With two years remaining under the loan agreement, AE acquires TE.

IE261. Included in the total fair value of TE is a CU90 financial liability for the fair value of the loan arrangement with AE. At the acquisition date, the carrying amount of the corresponding financial asset in AE's financial statements (the amortized cost of the loan) is CU100.

IE262. In this example, AE calculates a loss of CU10. The loss is calculated as the difference between the fair value of the financial liability assumed and carrying amount of the corresponding financial asset previously recognized by AE. In its consolidated financial statements, AE will eliminate its financial asset (CU100) against the fair value of TE's financial liability (CU90), the difference representing the loss to AE.

Settlement of a Pre-Existing Relationship – Transfers

Illustrating the Consequences of Applying Paragraphs 109–110 and AG98–AG101 of IPSAS 40.

IE263. On 1 January 20X7, AE acquires TE. Previously, on 1 October 20X6, AE provided TE with a grant of CU800 to be used in the provision of an agreed number of training courses.

IE264. The grant was subject to a condition that the grant would be returned proportionately to the number of training courses not delivered. At the acquisition date, TE had delivered a quarter of the agreed number of courses, and recognized a liability of CU600 in respect of its performance obligation, in accordance with IPSAS 23. Based on past experience, AE considered that TE was more likely than not to deliver the training courses. It was therefore not probable that there would be a flow of resources to AE, and AE did not recognize an asset in respect of the grant, but accounted for the full CU800 as an expense.

IE265. In this example, AE calculates a gain of CU600. The gain is calculated as the liability assumed that is derecognized because, as a result of the acquisition, there is no longer an obligation owed to a third party.

IE266. In this example, no corresponding asset had been recognized by AE; if AE had previously recognized a corresponding asset, this would be derecognized at the acquisition date, and the derecognized amount would be included in the calculation of the gain or loss.

Settlement of a Pre-Existing Relationship – Supply Contract

Illustrating the Consequences of Applying Paragraphs 109–110 and AG98–AG101 of IPSAS 40.

IE267. AE purchases electronic components from TE under a five-year supply contract at fixed rates. Currently, the fixed rates are higher than the rates at which AE could purchase similar electronic components from another supplier. The supply contract allows AE to terminate the contract before the end of the initial five-year term but only by paying a CU6 million penalty. With three years remaining under the supply contract, AE pays CU50 million to acquire TE, which is the fair value of TE based on what other market participants would be willing to pay.

IE268. Included in the total fair value of TE is CU8 million related to the fair value of the supply contract with AE. The CU8 million represents a CU3 million component that is 'at market' because the pricing is comparable to pricing for current market transactions for the same or similar items (selling effort, customer relationships and so on) and a CU5 million component for pricing that is unfavorable to AE because it exceeds the price of current market transactions for similar items. TE has no other identifiable assets or liabilities related to the supply contract, and AE has not recognized any assets or liabilities related to the supply contract before the acquisition.

IE269. In this example, AE calculates a loss of CU5 million (the lesser of the CU6 million stated settlement amount and the amount by which the contract is unfavorable to the acquirer) separately from the acquisition. The CU3 million 'at-market' component of the contract is part of goodwill.

IE270. Whether AE had recognized previously an amount in its financial statements related to a pre-existing relationship will affect the amount recognized as a gain or loss for the effective settlement of the relationship. Suppose that IPSASs had required AE to recognize a CU6 million liability for the supply contract before the acquisition. In that situation, AE recognizes a CU1 million settlement gain on the contract in surplus or deficit at the acquisition date (the CU5 million measured loss on the contract less the CU6 million loss previously recognized). In other words, AE has in effect settled a recognized liability of CU6 million for CU5 million, resulting in a gain of CU1 million.

Contingent Payments to Employees in an Acquisition

Illustrating the Consequences of Applying Paragraphs 109–110, AG98 and AG102– AG103 of IPSAS 40.

IE271. TE appointed a candidate as its new CEO under a ten-year contract. The contract required TE to pay the candidate CU5 million if TE is acquired before the contract expires. AE acquires TE eight years later. The CEO was still employed at the acquisition date and will receive the additional payment under the existing contract.

IE272. In this example, TE entered into the employment agreement before the negotiations of the combination began, and the purpose of the agreement was to obtain the services of CEO. Thus, there is no evidence that the agreement was arranged primarily to provide benefits to AE or the combined entity. Therefore, the liability to pay CU5 million is included in the application of the acquisition method.

IE273. In other circumstances, TE might enter into a similar agreement with CEO at the suggestion of AE during the negotiations for the acquisition. If so, the primary purpose of the agreement might be to provide severance pay to CEO, and the agreement may primarily benefit AE or the combined entity rather than TE or its former owners. In that situation, AE accounts for the liability to pay CEO in its post-combination financial statements separately from application of the acquisition method.

Subsequent Measurement of Transfers, Concessionary Loans and Similar Benefits Received by an Acquirer or an Acquired Operation on the Basis of Criteria that May Change as a Result of an Acquisition

Illustrating the Consequences of Applying Paragraphs 114 and AG109–AG111 of IPSAS 40.

IE274. The following example illustrates the subsequent accounting for a transfer received by an acquirer on the basis of criteria that may change as a result of an acquisition.

IE275. On 1 January 20X6, a national government provides an annual grant to those municipalities where their revenue per head of population is below a threshold. On 1 June 20X3 AE, a municipality, acquires TE, a shopping complex that will generate revenue for AE. AE had previously received a grant of CU500, based on its revenue per head of population.

IE276. As a result of its acquisition of TE on 1 June 20X3, the revenue per head of population of AE increases above the threshold that the government had set when allocating grants.

IE277. On 1 July 20X3, the national government requires AE to repay a portion (CU100) of the grant previously received by AE. AE recognizes a liability and an expense of CU100 on 1 July 20X3.

Disclosure Requirements Relating to Acquisitions

Illustrating the Consequences of Applying the Disclosure Requirements in Paragraphs 119–125 of IPSAS 40.

IE278. The following example illustrates some of the disclosure requirements relating to acquisitions; it is not based on an actual transaction. The example assumes that AE is a public sector entity with responsibility for healthcare in its region and that TE is a listed entity. The illustration presents the disclosures in a tabular format that refers to the specific disclosure requirements illustrated. An actual footnote might present many of the disclosures illustrated in a simple narrative format.

Paragraph reference		
120(a)–(d)	On 30 June 20X2 AE acquired 75 percent of the ordinary shares of TE and obtained control of TE. An analysis of the economic substance of the combination confirms the transaction is an acquisition. TE is a provider of medical supplies. As a result of the acquisition, AE is expected to deliver improved healthcare to its residents. It also expects to reduce costs through economies of scale.	
120(e)	The goodwill of CU2,500 arising from the acquisition consists largely of the synergies and economies of scale expected from combining the operations of AE and TE.	
120(k)	None of the goodwill recognized is expected to be deductible for income tax purposes. The following table summarizes the consideration paid for TE and the amounts of the assets acquired and liabilities assumed recognized at the acquisition date, as well as the fair value at the acquisition date of the non-controlling interest in TE.	
	At 30 June 20X2	
	Consideration	**CU**
120(f)(i)	Cash	11,000
120(f)(iii); 120(g)(i)	Contingent consideration arrangement	1,000
120(f)	**Total consideration transferred**	12,000
120(m)	**Acquisition-related costs** (included in selling, general and administrative expenses in AE's statement of comprehensive income for the year ended 31 December 20X2)	1,250
120(i)	**Recognized amounts of identifiable assets acquired and liabilities assumed**	
	Financial assets	3,500
	Inventory	1,000
	Property, plant and equipment	10,000
	Identifiable intangible assets	3,300
	Financial liabilities	(4,000)
	Contingent liability	(1,000)
	Total identifiable net assets	12,800
120(p)(i)	**Non-controlling interest in TE**	(3,300)
	Goodwill	2,500
		12,000
120(f)(iii) 120(g) 124(b)	The contingent consideration arrangement requires AE to pay the former owners of TE 5 percent of the revenues of XE, an unconsolidated equity investment owned by TE, in excess of CU7,500 for 20X3, up to a maximum amount of CU2,500 (undiscounted). The potential undiscounted amount of all future payments that AE could be required to make under the contingent consideration arrangement is between CU0 and CU2,500. The fair value of the contingent consideration arrangement of CU1,000 was estimated by applying an income approach. Key assumptions include a discount rate range of 20–25 percent and assumed probability-adjusted revenues in XE of CU10,000–20,000. As of 31 December 20X2, neither the amount recognized for the contingent consideration arrangement, nor the range of outcomes or the assumptions used to develop the estimates had changed.	
120(h)	The fair value of the financial assets acquired includes receivables with a fair value of CU2,375. The gross amount due under the contracts is CU3,100, of which CU450 is expected to be uncollectible.	

Paragraph reference	
124(a)	The fair value of the acquired identifiable intangible assets of CU3,300 is provisional pending receipt of the final valuations for those assets.
120(j) 124(c) IPSAS 19.97, 98	A contingent liability of CU1,000 has been recognized for expected warranty claims on products sold by TE during the last three years. We expect that the majority of this expenditure will be incurred in 20X3 and that all will be incurred by the end of 20X4. The potential undiscounted amount of all future payments that AE could be required to make under the warranty arrangements is estimated to be between CU500 and CU1,500. As of 31 December 20X2, there has been no change since 30 June 20X2 in the amount recognized for the liability or any change in the range of outcomes or assumptions used to develop the estimates.
120(p)	The fair value of the non-controlling interest in TE, a listed entity, was measured using the closing market price of TE's ordinary shares on the acquisition date.
120(r)(i)	The revenue included in the consolidated statement of comprehensive income since 30 June 20X2 contributed by TE was CU4,090. TE also contributed profit of CU1,710 over the same period.
120(r)(ii)	Had TE been consolidated from 1 January 20X2 the consolidated statement of comprehensive income would have included revenue of CU27,670 and profit of CU12,870.

In considering the disclosures related to an acquisition, an entity may find it helpful to refer to the discussion of materiality in IPSAS 1.

Comparison with IFRS 3

The acquisition accounting requirements in IPSAS 40 are drawn primarily from IFRS 3 (issued in 2004, including amendments up to December 31, 2015). The main differences between these requirements in IPSAS 40 and IFRS 3 are as follows:

- IFRS 3 includes guidance on determining the acquirer. In IPSAS 40, this is addressed when classifying a public sector combination as either an amalgamation or an acquisition.
- IPSAS 40 contains additional guidance on public sector specific transactions, for example tax forgiveness.
- IPSAS 40 uses different terminology, in certain instances, from IFRS 3. The most significant examples are the use of the terms “public sector combination”, “operation”, and “acquired operation”. The equivalent terms in IFRS 3 are “business combination”, “business” and “acquiree”.

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