

THE FUTURE OF
FINANCIAL REPORTING
IN THE UK AND REPUBLIC OF IRELAND

REVISED FINANCIAL
REPORTING EXPOSURE
DRAFTS

46 47 & 48

PART TWO:
THE DRAFT STANDARDS



ACCOUNTING
STANDARDS
BOARD

FINANCIAL REPORTING
EXPOSURE DRAFT

This draft is issued by the Accounting Standards Board for comment. It should be noted that the draft may be modified in the light of comments received before being issued in final form.

For ease of handling, we prefer comments to be sent by email to:

asbcommentletters@frc-asb.org.uk

Comments may also be sent in hard copy form to:

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Comments should be despatched so as to be received no later than 30 April 2012. All replies will be regarded as on the public record, unless confidentiality is requested by the commentator.

The FRC's policy is to publish on its website all responses to formal consultations issued by the FRC and/or any of its operating bodies unless the respondent explicitly requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure.

We do not edit personal information (such as telephone numbers or email addresses) from submissions; therefore, only information that you wish to be published should be submitted.

We aim to publish responses within 10 working days of receipt.

We will publish a summary of the consultation responses, either as part of, or alongside, our final decision.

**REVISED FINANCIAL REPORTING
EXPOSURE DRAFTS**

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**Part Two:
The Draft Financial
Reporting Standards**



**ACCOUNTING
STANDARDS
BOARD**

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**REVISED FINANCIAL REPORTING
EXPOSURE DRAFT**

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**APPLICATION OF FINANCIAL REPORTING
REQUIREMENTS
[DRAFT FRS 100]**

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[DRAFT] SUMMARY

- 1 In 201[2] the Accounting Standards Board (ASB) revised financial reporting standards in the United Kingdom and Republic of Ireland. The revisions fundamentally reformed financial reporting, replacing extant standards with three [draft] Financial Reporting Standards:

FRS 100 ‘Application of Financial Reporting Requirements’;

FRS 101 ‘Reduced Disclosure Framework’; and

FRS 102 ‘The Financial Reporting Standard applicable in the UK and Republic of Ireland’.

- 2 The revisions made by the ASB followed a sustained and detailed period of consultation. The ASB made these fundamental changes recognising that the introduction of International Financial Reporting Standards for listed groups in 2002 (with application from 2005) called into question the need for two sets of financial reporting standards. Evidence from consultation supported a move towards an international based framework for financial reporting, but one that was proportionate to the needs of preparers and users.
- 3 The ASB’s objective is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and the users’ information needs.
- 4 In meeting its objective, the ASB aims to provide succinct financial reporting standards that:
 - have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;
 - reflect up-to-date thinking and developments in the way businesses operate and the transactions they undertake;
 - balance consistent principles for accounting by all UK and Republic of Ireland entities with pragmatic solutions, based on size, complexity, public interest and users’ information needs;
 - promote efficiency within groups; and
 - are cost-effective to apply.
- 5 The requirements in this [draft] Financial Reporting Standard (FRS) take into consideration the findings from the previous consultations on the future of financial reporting in the UK and Republic of Ireland.
- 6 This [draft] FRS sets out financial reporting requirements which are dependent on the status of the entity (and not that of its parent). An entity that is required by EU Regulation 1606/2002 (or other legislation or regulation) to prepare consolidated financial statements in accordance with standards and interpretations issued (or adopted) by the International Accounting Standards Board that have been adopted in the European Union (EU-adopted IFRS) must do so. The individual accounts of such an entity, or the individual accounts or consolidated financial statements of any other entity within the scope of this [draft] FRS, must be prepared in accordance with the following requirements:
 - (a) If the entity is eligible to apply the Financial Reporting Standard for Small Entities (FRSSE), it may prepare its financial statements in accordance with that standard;
 - (b) If the entity is not eligible to apply the FRSSE, or if the entity is eligible to apply the FRSSE but chooses not to do so, the entity must apply [draft] FRS 102, EU-adopted IFRS

or, for financial statements that are the individual accounts of a qualifying entity, [draft] FRS 101.

- 7 [draft] FRS 101 sets out a reduced disclosure framework which addresses the financial reporting requirements and disclosure exemptions for the financial statements of subsidiaries and ultimate parents that otherwise apply the recognition, measurement and disclosure requirements of EU-adopted IFRS.
- 8 [draft] FRS 102 is a single financial reporting standard that aims to provide entities with succinct financial reporting requirements.
- 9 The FRSSE sets out the financial reporting requirements for smaller entities as defined by the Companies Act 2006, or entities which are not companies but would otherwise meet the criteria of a small company.

[DRAFT] FINANCIAL REPORTING STANDARD 100: APPLICATION OF FINANCIAL REPORTING REQUIREMENTS

OBJECTIVE

- 1 The objective of this [draft] Financial Reporting Standard (FRS) is to set out the financial reporting requirements for UK and Republic of Ireland entities preparing financial statements.

SCOPE

- 2 This [draft] FRS applies to financial statements that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income and expenditure) for a period.

ABBREVIATIONS AND DEFINITIONS

- 3 The terms **Act**, **EU-adopted IFRS**, **[draft] FRS 100**, **[draft] FRS 101**, **[draft] FRS 102**, **FRSSE**, **IAS Regulation**, **IFRS**, **individual accounts**, **Regulations** and **SORP** are explained in the glossary included as Appendix I to this [draft] FRS.
- 4 A **qualifying entity** is a member of a group that prepares publicly available financial statements, which are intended to give a true and fair view, in which that member is consolidated.
- 5 A **financial institution** is either:
 - (a) a bank which is:
 - (i) a firm with a Part IV permission* which includes accepting deposits; and:
 - a. which is a credit institution; or
 - b. whose Part IV permission includes a requirement that it complies with the rules in the General Prudential sourcebook and the Prudential sourcebook for Banks, Building Societies and Investment Firms relating to banks, but which is not a building society, a friendly society or a credit union; or
 - (ii) an EEA bank which is a full credit institution; or
 - (b) a building society which is defined in section 119(1) of the Building Societies Act 1986 as a building society incorporated (or deemed to be incorporated) under that Act; or
 - (c) an entity that undertakes the business of effecting or carrying out insurance contracts, including general and life assurance entities; or
 - (d) an investment trust, Irish Investment Company[†], venture capital trust, mutual fund, exchange traded fund, unit trust, open-ended investment company (OEIC), custodian bank or stockbroker; or
 - (e) a credit union, being a body corporate registered under the Industrial and Provident Societies Act 1965 as a credit union in accordance with the Credit Unions Act 1979, which is an authorised person; or

* As defined in section 40(4) of the Financial Services and Markets Act 2000.

† An Investment Company is a corporate vehicle formed under section 47(3) of the Companies (Amendment) Act 1983 and section 58 of the Companies (Amendment) Act 1986, and regulated by the Irish Financial Regulator.

- (f) an incorporated friendly society or a registered friendly society; or
 - (g) a retirement benefit plan.
- 6 A **public benefit entity** is an entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any equity is provided with a view to supporting the entity's primary objectives rather than with a view to providing a financial return to equity providers, shareholders or members.

BASIS OF PREPARATION OF FINANCIAL STATEMENTS*

- 7 An entity that is required by the IAS Regulation (or other legislation or regulation) to prepare consolidated financial statements in accordance with EU-adopted IFRS must do so. The individual accounts of such an entity, or the individual accounts or consolidated financial statements of any other entity within the scope of this [draft] FRS, must be prepared in accordance with the following requirements:
- (a) if the entity is eligible to apply the FRSSE, it may prepare its financial statements in accordance with that standard;
 - (b) if the entity is not eligible to apply the FRSSE, or if the entity is eligible to apply the FRSSE but chooses not to do so, the entity must apply [draft] FRS 102, EU-adopted IFRS[†] or, for financial statements that are the individual accounts of a qualifying entity, [draft] FRS 101.^{‡,§}

APPLICATION OF STATEMENTS OF RECOMMENDED PRACTICE

- 8 Where an entity's financial statements fall within the scope of a SORP, the entity should state in its financial statements the title of the SORP and whether its financial statements have been prepared in accordance with the SORP's provisions currently in effect^{||}. In the event of a departure from these provisions, the entity should give a brief description of how the financial statements depart from the recommended practice set out in the SORP, which should include:
- (a) for any treatment that is not in accordance with the SORP, the reasons why the treatment adopted is judged more appropriate to the entity's particular circumstances, and
 - (b) brief details of any disclosures recommended by the SORP that have not been provided, and the reasons why they have not been provided.
- 9 SORPs recommend particular accounting treatments and disclosures with the aim of narrowing areas of difference and variety between comparable entities. Compliance with a SORP that has been generally accepted by an industry or sector leads to enhanced comparability between the financial statements of entities in that industry or sector. Comparability is further enhanced if users are made aware of the extent to which an entity complies with a SORP, and the reasons for any departures. The effect of a departure from a SORP need not be quantified, except in those rare cases where such quantification is necessary for the entity's financial statements to give a true and fair view.

* The requirements in this section are applicable to public benefit entities and other entities, not just to companies. Further relevant information can be found at paragraph A2.18 of Appendix II.

† Section 395(2) of the Act specifies that the individual accounts of a company that is a charity must be Companies Act individual accounts, so the option to apply EU-adopted IFRS is not available to such entities.

‡ An entity that prepares financial statements that are intended to give a true and fair view prepares those financial statements in accordance with paragraph 7.

§ Individual accounts that are prepared by a company in accordance with [draft] FRS 101 or [draft] FRS 102 are Companies Act individual accounts (section 395(1)(a) of the Act), whereas individual accounts that are prepared by a company in accordance with EU-adopted IFRS are IAS individual accounts (section 395(1)(b) of the Act).

|| The provisions of a SORP will cease to have effect, for example, to the extent that they conflict with a more recent financial reporting standard.

- 10 Entities whose financial statements do not fall within the scope of a SORP may, if the SORP is otherwise relevant to them, nevertheless choose to comply with the SORP's recommendations when preparing financial statements. Where this is the case, entities are encouraged to disclose that fact.

STATEMENT OF COMPLIANCE

- 11 Where an entity prepares financial statements in accordance with [draft] FRS 102 and does not take advantage of any of the disclosure exemptions set out in that standard, it shall state in the notes to the financial statements: *"These financial statements were prepared in accordance with [draft] Financial Reporting Standard 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'."*
- 12 Where a qualifying entity prepares financial statements in accordance with [draft] FRS 102 and takes advantage of the disclosure exemptions set out in that standard, it shall state in the notes to the financial statements: *"These financial statements were prepared in accordance with [draft] Financial Reporting Standard 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland', and the reduced disclosure framework set out in that standard was applied."*
- 13 Where a qualifying entity prepares its financial statements in accordance with [draft] FRS 101, it shall state in the notes to the financial statements: *"These financial statements were prepared in accordance with [draft] Financial Reporting Standard 101 'Reduced Disclosure Framework'."*

DATE FROM WHICH EFFECTIVE AND TRANSITIONAL ARRANGEMENTS

- 14 An entity shall apply this [draft] FRS, and [draft] FRS 101 or [draft] FRS 102 where applicable in accordance with paragraph 7, for accounting periods beginning on or after [1 January 2015]. Early application is permitted for accounting periods beginning on or after the date of issue of those standards, subject to the additional requirement for a public benefit entity that it must also apply a public benefit entity SORP which has been developed in accordance with those standards.
- 15 Details of Statements of Standard Accounting Practice (SSAPs), FRSs and Urgent Issues Task Force Abstracts (UITF abstracts) that are withdrawn on application of this [draft] FRS, [draft] FRS 101 and [draft] FRS 102 are set out in paragraph 20 of this [draft] FRS.
- 16 On the withdrawal of FRSs extant at the date of adoption of the requirements in this [draft] FRS, [draft] FRS 101 and [draft] FRS 102, or when an entity changes the basis of preparation of its financial statements within the requirements of this [draft] FRS, it shall apply the transitional arrangements relevant to its circumstances as follows:
- (a) an entity transitioning to EU-adopted IFRS shall apply the transitional arrangements set out in IFRS 1 'First-time adoption of International Financial Reporting Standards'.
 - (b) a qualifying entity transitioning to [draft] FRS 101 shall, unless it is applying EU-adopted IFRS at the date of transition (see paragraph 17), apply the requirements of paragraphs 6–33 of IFRS 1 'First-time Adoption of International Financial Reporting Standards' including the relevant appendices; references to IFRSs in IFRS 1 are interpreted to mean EU-adopted IFRS as amended in accordance with paragraph 7(b) of [draft] FRS 101.
 - (c) an entity transitioning to [draft] FRS 102 shall apply the transitional arrangements set out in [draft] FRS 102.
 - (d) an entity transitioning to the FRSSE shall apply the transitional arrangements set out in the FRSSE.

- 17 A qualifying entity applying EU-adopted IFRS at the date of transition will, if and when it takes advantage of the disclosure exemptions set out in [draft] FRS 101, no longer be preparing IAS accounts in accordance with section 395(1)(b) of the Act.* It shall consider whether amendments are required to comply with paragraph 7(b) of [draft] FRS 101, but it does not reapply the provisions of IFRS 1. Where amendments in accordance with paragraph 7(b) of [draft] FRS 101 are required, the entity shall determine whether the amendments have a material effect on the first financial statements presented. Where there is:
- (a) no material effect, the qualifying entity shall disclose that it has undergone transition to [draft] FRS 101 and that it has taken advantage of disclosure exemptions set out in [draft] FRS 101, for all periods presented.
 - (b) a material effect, the qualifying entity's first financial statements shall include:
 - (i) a description of the nature of each change in accounting policy;
 - (ii) reconciliations of its equity determined in accordance with EU-adopted IFRS to its equity determined in accordance with [draft] FRS 101 for both the date of transition to [draft] FRS 101 and for the end of the latest period presented in the entity's most recent annual financial statements prepared in accordance with its previous financial reporting framework; and
 - (iii) a reconciliation of the profit or loss determined in accordance with EU-adopted IFRS to its profit or loss determined in accordance with [draft] FRS 101 for the latest period presented in the entity's most recent annual financial statements prepared in accordance with its previous financial reporting framework.
- 18 Where paragraph 17(b) applies and it is impracticable to apply the amendments retrospectively, a qualifying entity shall apply the amendments to the earliest period for which it is practicable to do so, and it shall identify the data presented for prior periods that are not comparable with data for the period in which it prepares its first financial statements that conform with the reduced disclosure framework set out in [draft] FRS 101.
- 19 A qualifying entity transitioning to [draft] FRS 102 may take advantage of the reduced disclosure framework set out in [draft] FRS 102 in its first year of application of [draft] FRS 102.

WITHDRAWAL OF CURRENT ACCOUNTING STANDARDS

- 20 The following SSAPs, FRSs and UITF abstracts are withdrawn:
- SSAP 4 'Accounting for government grants';
 - SSAP 5 'Accounting for value added tax';
 - SSAP 9 'Stocks and long-term contracts';
 - SSAP 13 'Accounting for research and development';
 - SSAP 19 'Accounting for investment properties';
 - SSAP 20 'Foreign currency translation';
 - SSAP 21 'Accounting for leases and hire purchase contracts; including the Guidance Notes on SSAP 21';

* Further relevant information can be found at paragraph A2.13 of Appendix II.

SSAP 25 'Segmental reporting';

FRS 1 'Cash flow statements' (revised 1996);

FRS 2 'Accounting for subsidiary undertakings';

FRS 3 'Reporting financial performance';

FRS 4 'Capital instruments';

FRS 5 'Reporting the substance of transactions';

FRS 6 'Acquisitions and mergers';

FRS 7 'Fair values in acquisition accounting';

FRS 8 'Related party disclosures';

FRS 9 'Associates and joint ventures';

FRS 10 'Goodwill and intangible assets';

FRS 11 'Impairment of fixed assets and goodwill';

FRS 12 'Provisions, contingent liabilities and contingent assets';

FRS 13 'Derivatives and other financial instruments: disclosures';

FRS 15 'Tangible fixed assets';

FRS 16 'Current tax';

FRS 17 'Retirement benefits';

FRS 18 'Accounting policies';

FRS 19 'Deferred tax';

FRS 20 (IFRS 2) 'Share-based payment';

FRS 21 (IAS 10) 'Events after the balance sheet date';

FRS 22 (IAS 33) 'Earnings per share';

FRS 23 (IAS 21) 'The effects of changes in foreign exchange rates';

FRS 24 (IAS 29) 'Financial reporting in hyperinflationary economies';

FRS 25 (IAS 32) 'Financial instruments: Presentation';

FRS 26 (IAS 39) 'Financial instruments: Recognition and Measurement';

FRS 28 'Corresponding amounts';

FRS 29 (IFRS 7) 'Financial instruments: disclosures';

FRS 30 'Heritage assets';

- UITF abstract 4: 'Presentation of long-term debtors in current assets';
- UITF abstract 5: 'Transfers from current assets to fixed assets';
- UITF abstract 9: 'Accounting for operations in hyper-inflationary economies';
- UITF abstract 11: 'Capital instruments: issuer call options';
- UITF abstract 15: (revised 1999) 'Disclosure of substantial acquisitions';
- UITF abstract 19: 'Tax on gains and losses on foreign currency borrowings that hedge an investment in a foreign enterprise';
- UITF abstract 21: 'Accounting issues arising from the proposed introduction of the euro';
- UITF abstract 22: 'The acquisition of a Lloyd's business';
- UITF abstract 23: 'Application of the transitional rules in FRS 15';
- UITF abstract 24: 'Accounting for start-up costs';
- UITF abstract 25: 'National Insurance contributions on share option gains';
- UITF abstract 26: 'Barter transactions for advertising';
- UITF abstract 27: 'Revision to estimates of the useful economic life of goodwill and intangible assets';
- UITF abstract 28: 'Operating lease incentives';
- UITF abstract 29: 'Website development costs';
- UITF abstract 31: 'Exchanges of businesses or other non-monetary assets for an interest in a subsidiary, joint venture or associate';
- UITF abstract 32: 'Employee benefit trusts and other intermediate payment arrangements';
- UITF abstract 34: 'Pre-contract costs';
- UITF abstract 35: 'Death-in-service and incapacity benefits';
- UITF abstract 36: 'Contracts for sales of capacity';
- UITF abstract 38: 'Accounting for ESOP trusts';
- UITF abstract 39: '(IFRIC Interpretation 2) Members' shares in co-operative entities and similar instruments';
- UITF abstract 40: 'Revenue recognition and service contracts';
- UITF abstract 41: '(IFRIC Interpretation 8) Scope of FRS 20 (IFRS 2)';
- UITF abstract 42: '(IFRIC Interpretation 9) Reassessment of embedded derivatives';
- UITF abstract 43: 'The interpretation of equivalence for the purposes of section 228A of the Companies Act 1985';

UITF abstract 44: (IFRIC Interpretation 11) ‘FRS 20 (IFRS 2) Group and treasury share transactions’;

UITF abstract 45: (IFRIC Interpretation 6) ‘Liabilities arising from participating in a specific market – Waste electrical and electronic equipment’;

UITF abstract 46: ‘(IFRIC Interpretation 16) Hedges of a net investment in a foreign operation’;

UITF abstract 47: ‘(IFRIC Interpretation 19) Extinguishing Financial Liabilities with Equity Instruments’; and

UITF abstract 48: ‘Accounting implications of the replacement of the retail prices index with the consumer prices index for retirement benefits’.

- 21 The ASB will also withdraw the following statements:

‘Statement of principles for financial reporting’;

‘Statement of principles for financial reporting – interpretations for public benefit entities’;

Reporting Statement: ‘Retirement Benefits – Disclosures’; and

Statement: ‘Half-Yearly Financial Reports’.

CONSEQUENTIAL AMENDMENTS TO THE FRSSE

- 22 The following consequential amendments are proposed to the FRSSE:

- (a) Paragraph 1 of the Status of the FRSSE is amended as follows (deleted text is struck through, underlined text is inserted):

The Financial Reporting Standard for Smaller Entities (effective [January 2015] ~~April 2008~~) – the FRSSE – prescribes the basis, for those entities within its scope that have chosen to adopt it, for preparing and presenting their financial statements. The definitions and accounting treatments are consistent with the requirements of companies legislation and, for the generality of small entities, are the same as those previously required by other accounting standards or a simplified version of those requirements. ~~The disclosure requirements exclude a number of those stipulated in other accounting standards.~~

- (b) Paragraph 2 of the Status of the FRSSE is amended as follows (deleted text is struck through, underlined text is inserted):

Reporting entities that apply the FRSSE, and [draft] FRS 100 ‘Application of Financial Reporting Requirements’, are exempt from complying with other Financial Reporting Standards (FRSs) ~~accounting standards. (Statements of Standard Accounting Practice and Financial Reporting Standards) and Urgent Issues Task Force (UITF) Abstracts, unless preparing consolidated financial statements, in which case certain other accounting standards apply, as set out in paragraph 16.1.~~

- (c) Paragraph 4 of the Status of the FRSSE is deleted and a new paragraph is inserted (underlined text is inserted):

The only significant differences between this version of the FRSSE (effective [January 2015]) and the FRSSE (effective April 2008) are in respect of the [draft] revised reporting framework introduced into the UK effective [January 2015]. As part of the [draft] revised reporting framework, the ASB is withdrawing extant Financial Reporting Standards and

Urgent Issues Task Force (UITF) Abstracts. It has made consequential amendments to the FRSSE where it previously referred to withdrawn standards or Abstracts.

- (d) Paragraph 5 of the Status of the FRSSE is amended as follows (deleted text is struck through, underlined text is inserted):

Financial statements will generally be prepared using accepted practice and, accordingly, for transactions or events not dealt with in the FRSSE, smaller entities should first have regard to their own existing accounting policies. Where an entity applying the FRSSE undertakes a new transaction for which it has no existing policy, in developing a new policy it should have regard to [draft] FRS 102 ‘The Financial Reporting Standard applicable in the UK and Republic of Ireland’, ~~other accounting standards and UITF Abstracts,~~ not as a mandatory document, but as a means of establishing current practice. Public benefit entities (PBEs) as defined in [draft] FRS 102 should in particular have regard to the PBE specific requirements in [draft] FRS 102.

- (e) Paragraph 6 of the Status of the FRSSE is amended as follows (deleted text is struck through, underlined text is inserted):

When considering the application of accounting standards, including [draft] FRS 102 ‘The Financial Reporting Standard applicable in the UK and Republic of Ireland’, and UITF Abstracts to smaller entities, the Accounting Standards Board has had, and will continue to have, regard to the following criteria...

- (f) Paragraph 10 of the Status of the FRSSE is amended as follows (deleted text is struck through, underlined text is inserted):

Reporting entities that are entitled to adopt the FRSSE, but choose not to do so, are required to apply EU-adopted IFRS, [draft] FRS 101 ‘Reduced Disclosure Framework’ or [draft] FRS 102 ‘The Financial Reporting Standard applicable in the UK and Republic of Ireland’ in accordance with the requirements of [draft] FRS 100 ‘Application of Financial Reporting Requirements’. ~~should apply Statements of Standard Accounting Practice (SSAPs), other Financial Reporting Standards (FRSs) and UITF Abstracts when preparing financial statements intended to give a true and fair view of the financial position and profit or loss of the entity.~~

- (g) Paragraph 11 of the Status of the FRSSE is amended as follows (deleted text is struck through, underlined text is inserted):

Statements of Recommended Practice (SORPs) and other equivalent guidance developed or revised after the FRSSE was first issued (in November 1997) may specify the circumstances, if any, in which entities in the industry or sector addressed in the SORP or equivalent guidance may adopt the current version of the FRSSE.

[insert paragraph break]

~~Where Financial statements that purport to comply with existing SORPs that are drafted on the basis that the financial statements comply with of the requirements of SSAPs, FRSs (other than the FRSSE), including [draft] FRS 102 ‘The Financial Reporting Standard applicable in the UK and Republic of Ireland’, and UITF Abstracts, or EU-adopted IFRS, financial statements cannot be said to comply with those SORPs if they are prepared in accordance with~~ should also observe those requirements rather than adopt the FRSSE.

- (h) Paragraph 2.6 of the FRSSE is amended as follows (deleted text is struck through, underlined text is inserted):

The financial statements shall state that they have been prepared in accordance with the Financial Reporting Standard for Smaller Entities (effective [January 2015] ~~April 2008~~).

- (i) The footnote to paragraph 2.6 of the FRSSE is amended as follows (deleted text is struck through, underlined text is inserted):

This statement may be included with the note of accounting policies or, for those entities taking advantage of the exemptions for small companies in companies legislation, in the statement required by companies legislation to be given on the balance sheet. For example, in United Kingdom the combined statement could read as follows “These accounts have been prepared in accordance with the ~~special provisions relating to~~ special provisions relating to small companies within Part 15 of the Companies Act 2006 and with the Financial Reporting Standard for Smaller Entities (effective January 2015 ~~April 2008~~).” If abbreviated accounts are also to be prepared, the statement referring to the Financial Reporting Standard for Smaller Entities (effective January 2015 ~~April 2008~~) shall be included with the note of accounting policies so that it is reproduced in the abbreviated accounts.

- (j) Paragraph 6.13 of the FRSSE is amended as follows (deleted text is struck through, underlined text is inserted):

Capitalised goodwill and intangible assets shall be considered to have a finite useful life, and shall be depreciated on a straight-line (or more appropriate) basis over their useful economic lives, ~~which~~ If an entity is unable to make a reliable estimate of the useful life of goodwill or intangible assets, the life shall be presumed to be not exceed 20 five years. THE PERIOD CHOSEN FOR DEPRECIATING GOODWILL AND THE REASONS FOR CHOOSING THAT PERIOD MUST BE DISCLOSED IN A NOTE TO THE ACCOUNTS.

- (k) Paragraph 6.45 is amended (deleted text is struck through):

Fixed assets and goodwill shall be carried in the balance sheet at no more than recoverable amount. If the net book amount of a fixed asset or goodwill is considered not to be recoverable in full at the balance sheet date (~~perhaps as a result of obsolescence or a fall in demand for a product~~), the net book amount shall be written down to the estimated recoverable amount, which shall then be written off over the remaining useful economic life of the asset.

- (l) Paragraph 6.45A-6.45C are inserted (underlined text is inserted):

At each reporting date an assessment shall be carried out of whether there is any indication that an asset may be impaired (ie that its carrying amount is more than its recoverable amount). If any such indication exists, the recoverable amount of the asset shall be estimated. If there is no indication of impairment, it is not necessary to estimate the recoverable amount.

In assessing whether there is any indication that an asset may be impaired, the following indications might be considered:

- (a) During the period, an asset’s market value has declined significantly more than would be expected as a result of the passage of time or normal use.
- (b) Significant changes with an adverse effect on an asset, or the entity, have taken place during the period, or will take place in the near future, (for example external factors such as technological, market, economic or legal changes or internal factors such as the asset becoming idle, or plans to dispose of an asset before the previously expected date).
- (c) Market interest rates have increased during the period, and those increases are likely to affect materially the asset’s recoverable amount.
- (d) Evidence is available of obsolescence or physical damage of an asset.

- (e) Evidence is available from internal reporting that indicates that operating results or cash flows from the use of the asset are, or will be, worse than expected.

If there is an indication that an asset may be impaired, this may indicate that the entity should review the remaining useful economic life, the depreciation method or the residual value for the asset and adjust it in accordance with paragraph 6.40 even if no impairment loss is recognised for the asset.

- (m) Paragraph 15.7 of the FRSSE is amended as follows (deleted text is struck through, underlined text is inserted):

Disclosure, as a **related party** transaction, is not required of:

- (a) pension contributions paid to a pension fund;
- (b) emoluments in respect of services as an employee of the reporting entity; ~~or~~
- (c) transactions with the parties listed below simply as a result of their role as:
 - (i) providers of finance in the course of their business in that regard;
 - (ii) utility companies;
 - (iii) **government** departments and their sponsored bodies; or
 - (iv) a customer, supplier, franchiser, distributor or general agent; or
- (d) related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly-owned by such a member.

- (n) Paragraph 16.2 of the FRSSE is amended as follows (deleted text is struck through, underlined text is inserted):

Where the reporting entity is preparing **consolidated financial statements**, it should have regard to paragraph 5 of the Status of the FRSSE as a means of developing its policies and practices for the preparation of its consolidated financial statements. ~~as standard the accounting practices and disclosure requirements set out in FRSs 2, 6, 7 and, as they apply in respect of consolidated financial statements, FRSs 5, 9, 10⁴, 11 and 28. Where the reporting entity is part of a group that prepares publicly available consolidated financial statements, it is entitled to the exemptions given in FRS 8 paragraph 3(a)-(c).~~

~~FRS 10 and, as directed by FRS 10, FRS 11 need be applied only in respect of purchased goodwill arising on consolidation.~~

- (o) Paragraph 19.1 of the FRSSE is amended as follows (deleted text is struck through, underlined text is inserted):

The accounting practices set out in this Financial Reporting Standard for Smaller Entities (effective [January 2015] ~~April 2008~~) shall be regarded as standard in respect of financial statements relating to accounting periods beginning on or after [1 January 2015] ~~6 April 2008~~. Earlier application is permitted.

- (p) Paragraph 20.1 of the FRSSE is amended as follows (deleted text is struck through, underlined text is inserted):

The Financial Reporting Standard for Smaller Entities (effective [January 2015] ~~April 2008~~) supersedes the FRSSE (effective April 2008 ~~January 2007~~).

- (q) In Part C ‘Definitions’, the definition of ‘Close family’ is deleted and is replaced with:

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and include:

- (a) that person’s children and spouse or domestic partner;
- (b) children of that person’s spouse or domestic partner; and
- (c) dependents of that person or that person’s spouse or domestic partner.

- (r) In Part C ‘Definitions’, the definition of a related party is deleted and replaced with (underlined text is inserted):

A related party is a person or entity that is related to the entity that is preparing its financial statements (in this Standard referred to as the ‘reporting entity’).

- (a) a person or a close member of that person’s family is related to a reporting entity if that person:
 - (i) has control or joint control over the reporting entity;
 - (ii) has significant influence over the reporting entity; or
 - (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.
- (b) an entity is related to a reporting entity if any of the following conditions applies:
 - (i) the entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
 - (ii) one entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
 - (iii) both entities are joint ventures of the same third party.
 - (iv) one entity is a joint venture of a third entity and the other entity is an associate of the third entity.
 - (v) the entity is a retirement benefit scheme for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a scheme, the sponsoring employers are also related to the reporting entity.
 - (vi) the entity is controlled or jointly controlled by a person identified in (a).
 - (vii) a person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

- (s) The final sentence of paragraph 35 to Appendix IV ‘Development of the FRSSE’ is deleted. Appendix V of the FRSSE (effective 2008) is deleted in full.
- (t) In Appendix IV ‘Development of the FRSSE’ after paragraph 37, paragraph 38 and 39 are renumbered 40 and 41 and new paragraphs 38 and 39, including the heading, are inserted as follows (underlined text is inserted):

The FRSSE (effective [January 2015])

In [month of issue of FRS] the ASB amended the FRSSE as a consequence of the significant changes that were made to UK and Republic of Ireland Financial Reporting Standards at this date. In [month of issue of FRS] the ASB revised extant Financial Reporting Standards, withdrawing its existing financial reporting standards and supplementary literature and replacing them with revised financial reporting requirements based on International Financial Reporting Standards. The FRSSE (effective April 2008) was amended as a consequence of these changes.

The consequential amendments to the FRSSE were to update references in the FRSSE (effective April 2008) to accounting standards that were withdrawn. In addition, the ASB explained that where an entity applying the FRSSE undertakes a new transaction for which it has no existing accounting policy it should have regard to [draft] FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland', not as a mandatory document but as a means of establishing current practice. The ASB removed the reference to the accounting standards applicable to consolidated financial statements because the general requirements in the FRSSE for developing accounting policies for transactions or events that are not dealt with in the FRSSE are equally applicable to consolidated financial statements.

The ASB made two further amendments to the FRSSE:

- (a) it revised the presumed life of capitalised goodwill and intangible assets to five years, which is consistent with the EU Directives. This applies when an entity is otherwise unable to make a reliable estimate of the useful life.
- (b) it clarified that an entity shall assess, annually, whether there is any indication that an asset is impaired. This will assist entities applying the existing requirement for fixed assets and goodwill to be carried at no more than their recoverable amount.

These amendments are helpful in applying existing company law requirements and should not result in significant changes or implementation costs for entities.

- (u) Renumbered paragraphs 40 and 41 are amended (deleted text is struck through, underlined text is inserted):

The FRSSE is designed to provide smaller entities with a single accounting standard that is focused on their particular circumstances. Smaller entities that choose to adopt the FRSSE are exempt from other accounting standards and UITF Abstracts ~~(with certain exceptions for those small groups preparing consolidated financial statements)~~. The Board accepts that the FRSSE is not comprehensive and that there may be issues of general application on which guidance will be sought. Preparers may come across transactions on which accounting guidance is not provided in the FRSSE. This raises the question of whether, in the absence of guidance within the FRSSE, preparers and auditors would be required to follow all SSAPs, other FRSS (including [draft] FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'), and UITF Abstracts to the extent that they provide guidance on transactions of relevance to the smaller entity. The Board's view, formulated after consultation with legal advisers and others, is that users expect financial statements to be prepared using accepted practice. If a practice was clearly established and accepted, it should be followed unless there were good reasons to depart from it. Accordingly, preparers and auditors should have regard to SSAPs, FRSS (including [draft] FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'), and UITF Abstracts not as mandatory documents, but as a means of establishing current practice.

In relation to earlier versions of the FRSSE, some respondents asked that there should be specific cross references within the FRSSE to SSAPs, other FRSS and UITF Abstracts (the

equivalent cross references would now be to [draft] FRS 102 ‘The Financial Reporting Standard applicable in the UK and Republic of Ireland’). The Board rejected this suggestion because the inclusion of cross-references would lead to preparers and auditors having to consider those other pronouncements in all cases, as well as the FRSSE, thereby lengthening checklists and adding to the burden. Furthermore, it is recognised that as new FRSs are issued (including introducing [draft] FRS 102 ‘The Financial Reporting Standard applicable in the UK and Republic of Ireland’) that amend generally accepted accounting practice as it applies to larger entities, it may not be appropriate for such rules to apply to smaller entities. ~~An example that has been frequently cited, but on which the Board has not established a firm position, is that some of the likely proposals on marking to market fixed interest instruments, while appropriate for larger entities, would not be appropriate for smaller entities. Because generally accepted accounting practice had not been established for all in this area then there would not be an expectation that smaller entities should have regard to such a rule.~~

APPLICATION GUIDANCE I: THE INTERPRETATION OF EQUIVALENCE

This application guidance forms an integral part of [draft] FRS 100

INTRODUCTION

AG1 Section 401 of the Act exempts, subject to certain conditions, an intermediate parent from the requirement to prepare consolidated financial statements where its parent is not established under the law of an EEA state. Section 401* states that:

“(2) Exemption is conditional upon compliance with all of the following conditions:

- (a) the company and all of its subsidiary undertakings must be included in consolidated accounts for a larger group drawn up to the same date, or to an earlier date in the same financial year, by a parent undertaking;
- (b) that those accounts and, where appropriate, the group’s annual report, must be drawn up
 - (i) in accordance with the provisions of the Seventh Directive (83/349/EEC) (as modified, where relevant, by the provisions of the Bank Accounts Directive (86/635/EEC) or the Insurance Accounts Directive (91/674/EEC)), or
 - (ii) in a manner **equivalent** to consolidated accounts and consolidated annual reports so drawn up;
- (c)

AG2 [draft] FRS 101 permits exemptions from disclosure where equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated.

AG3 This [draft] Application Guidance provides guidance on interpreting the meaning of equivalence in the two circumstances above.

SECTION 401 OF THE COMPANIES ACT 2006

AG4 Use of the exemption in section 401 requires an analysis of a particular set of consolidated financial statements to determine whether they are drawn up in a manner equivalent to consolidated financial statements that are in accordance with the Seventh Directive[†]. This Application Guidance aims to assist entities in adopting a consistent approach to this issue. In the absence of this guidance, companies and their auditors might feel obliged to take an overly cautious approach in response to uncertainty about whether the exemptions can be used.

AG5 It is generally accepted that the reference to equivalence in section 401 does not mean compliance with every detail of the Seventh Directive. A qualitative approach, ie with a focus on compliance with the basic requirements of the Directive and, in particular, the requirement to give a true and fair view, is more in keeping with the deregulatory nature of the exemption than a requirement to consider the detailed requirements on a checklist basis.

* In the Republic of Ireland, the wording of Regulation 9A of the European Communities (Companies: Group Accounts) Regulations 1992 is slightly different but the intention is the same and the phrase above in paragraph AG1(2)(b)(ii) is identical.

† The Seventh Directive deals with consolidated accounts and applies most of the requirements of the Fourth Directive to those consolidated accounts. Consideration of equivalence with the Seventh Directive therefore requires consideration of equivalence with the relevant provisions of the Fourth Directive. References in this [draft] Abstract to accounts being prepared in accordance with the Seventh Directive include, where appropriate, compliance with the relevant provisions of the Fourth Directive.

AG6 For the purpose of section 401 of the Act:

- (a) when assessing whether consolidated financial statements of a higher non-EEA parent are drawn up in a manner equivalent to consolidated financial statements drawn up in accordance with the Seventh Directive, it is necessary to consider whether they meet the basic requirements of the Fourth and Seventh Directives, in particular the requirement to give a true and fair view, without implying strict conformity with each and every provision; and
- (b) the consequences of adopting the principle in (a) above are:
 - (i) consolidated financial statements of the higher parent that give a true and fair view and comply with [draft] FRS 102 will meet the test of equivalence in the Seventh Directive;
 - (ii) consolidated financial statements of the higher parent prepared in accordance with EU-adopted IFRS will meet the test of equivalence in the Seventh Directive;
 - (iii) consolidated financial statements of the higher parent prepared in accordance with IFRS will meet the test of equivalence in the Seventh Directive, subject to the consideration of the reasons for any failure by the European Commission to adopt a standard or interpretation;
 - (iv) consolidated financial statements of the higher parent prepared using other GAAPs which are closely related to IFRS will meet the test of equivalence in the Seventh Directive, subject to consideration of the effect of any differences from EU-adopted IFRS; and
 - (v) consolidated financial statements of the higher parent prepared using other GAAPs should be assessed for equivalence with the Seventh Directive based on the particular facts, including the similarities to and differences from the Seventh Directive.

AG7 The European Securities and Markets Authority (ESMA; formerly the Committee of European Securities Regulators) has published its recommendation* to the European Commission on the equivalence of certain national GAAPs with EU-adopted IFRS.[†] ESMA's recommendations do not deal with equivalence with the Seventh Directive, which is generally less prescriptive than IFRS, and were conducted for a different purpose in connection with the Prospectus Directive and the Transparency Directive. Nevertheless, it is expected that similar principles will apply to the consideration of equivalence between the Seventh Directive and third countries' GAAPs as apply to the consideration of equivalence between those GAAPs and IFRS.

EQUIVALENT DISCLOSURES ARE INCLUDED IN THE CONSOLIDATED FINANCIAL STATEMENTS OF THE GROUP

AG8 In deciding whether the consolidated financial statements of the parent provide disclosures which are equivalent to the requirements of EU-adopted IFRS, from which relief is provided in paragraphs 8-9 of [draft] FRS 101, it is necessary to consider whether the consolidated financial statements of the parent provide disclosures that meet the basic disclosure requirements of the relevant standard or interpretation issued (or adopted) by the IASB, without requiring strict conformity with each and every disclosure. This assessment should be

* ESMA's advice on the equivalence of Chinese, Japanese and US GAAPs in March 2008, and ESMA's advice to the European Commission on Canadian and South Korean GAAPs in May 2008.

† Technical advice on the equivalence of certain third country GAAPs and on a description of certain third countries' mechanisms of enforcement of financial information (Ref: CESR/05-230b). The European Commission has announced plans to postpone by two years the implementation of the requirement for equivalence in the Prospectus and Transparency Directives, and so the ESMA guidance may not be implemented.

based on the particular facts, including the similarities to and differences from the requirements of the relevant standard from which relief is provided.

- AG9 The concept of 'equivalence' described in paragraph AG8 above is intended to be aligned to that described for section 401 of the Act.
- AG10 Disclosure exemptions for subsidiaries are permitted where the relevant disclosure requirements are met in the group accounts, even where the disclosures are made in aggregate or in an abbreviated form.

APPENDIX I: GLOSSARY

A1.1 The following terminology is used:

Act refers to the Companies Act 2006;

EU-adopted IFRS refers to IFRS that have been adopted in the European Union;

Financial institution refers to either:

- (a) a bank which is:
 - (i) a firm with a Part IV permission* which includes accepting deposits; and:
 - a. which is a credit institution; or
 - b. whose Part IV permission includes a requirement that it complies with the rules in the General Prudential sourcebook and the Prudential sourcebook for Banks, Building Societies and Investment Firms relating to banks, but which is not a building society, a friendly society or a credit union; or
 - (ii) an EEA bank which is a full credit institution; or
- (b) a building society which is defined in section 119(1) of the Building Societies Act 1986 as a building society incorporated (or deemed to be incorporated) under that Act; or
- (c) an entity that undertakes the business of effecting or carrying out insurance contracts, including general and life assurance entities; or
- (d) an investment trust, Irish Investment Company[†], venture capital trust, mutual fund, exchange traded fund, unit trust, open-ended investment company (OEIC), custodian bank or stockbroker; or
- (e) a credit union, being a body corporate registered under the Industrial and Provident Societies Act 1965 as a credit union in accordance with the Credit Unions Act 1979, which is an authorised person; or
- (f) an incorporated friendly society or a registered friendly society; or
- (g) a retirement benefit plan;

[draft] FRS 100 refers to [draft] FRS 100 ‘Application of Financial Reporting Requirements’;

[draft] FRS 101 refers to [draft] FRS 101 ‘Reduced Disclosure Framework’;

[draft] FRS 102 refers to [draft] FRS 102 ‘The Financial Reporting Standard applicable in the UK and Republic of Ireland’;

FRSSE refers to the FRS ‘Financial Reporting Standard for Smaller Entities’;

IAS Regulation refers to EU Regulation 1606/2002;

* As defined in section 40(4) of the Financial Services and Markets Act 2000.

† An Investment Company is a corporate vehicle formed under section 47(3) of the Companies (Amendment) Act 1983 and section 58 of the Companies (Amendment) Act 1986, and regulated by the Irish Financial Regulator.

IFRS refers to standards and interpretations issued (or adopted) by the International Accounting Standards Board (IASB). They comprise:

- (a) International Financial Reporting Standards;
- (b) International Accounting Standards; and
- (c) Interpretations developed by the IFRS Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC);

Public benefit entity refers to an entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any equity is provided with a view to supporting the entity's primary objectives rather than with a view to providing a financial return to equity providers, shareholders or members;

Qualifying entity refers to a member of a group that prepares publicly available financial statements, which give a true and fair view, in which that member is consolidated;

Regulations refers to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008; and

SORP refers to an extant Statement of Recommended Practice developed in accordance with SORPs: Policy and Code of Practice, and including a statement by the ASB. SORPs recommend accounting practices for specialised industries or sectors. They supplement accounting standards and other legal and regulatory requirements in the light of the special factors prevailing or transactions undertaken in a particular industry or sector.

- A1.2 The term **individual accounts**, from the Act, is also used; separate financial statements (defined in IFRS) are included within the meaning of this term.

APPENDIX II: NOTE ON LEGAL REQUIREMENTS

INTRODUCTION

- A2.1 This [draft] appendix provides an overview of how the proposals set out in this FRED address United Kingdom and Republic of Ireland company law requirements. It is therefore written from the perspective of a company to which the Companies Act 2006 applies. Specific legal requirements in the Republic of Ireland are available on the ASB website (www.frc.org.uk/asb).
- A2.2 Many entities that are not constituted as companies apply accounting standards promulgated by the ASB for the purposes of preparing financial statements that present a true and fair view. A brief consideration of the legal framework for some other entities can be found at A2.19. For those entities that are within the scope of a SORP, the relevant SORP will provide more details on the legal framework.
- A2.3 Reference to the Act in this Appendix refers to the Companies Act 2006. Reference to the Regulations refers to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

APPLICABLE ACCOUNTING FRAMEWORK

- A2.4 Group accounts of certain parent entities* are required by Article 4 of EU Regulation 1606/2002 (IAS Regulation) to be prepared in accordance with EU-adopted IFRS.
- A2.5 All other entities, except those that are permitted to and elect to apply the small companies' regime, must apply [draft] FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland', standards and interpretations issued (or adopted) by the International Accounting Standards Board that have been adopted in the European Union (EU-adopted IFRS) or, for financial statements that are individual accounts of a qualifying entity, [draft] FRS 101 'Reduced Disclosure Framework'.
- A2.6 Accounts prepared in accordance with EU-adopted IFRS are 'IAS accounts', and are within the scope of the IAS Regulation. All other accounts are classified as 'Companies Act accounts', including those of qualifying entities applying [draft] FRS 101, and are therefore required to comply with the applicable provisions of Part 15 of the Act and with the Regulations.

Financial Reporting by Small Entities

- A2.7 Entities that are permitted, in accordance with the Act (or by analogy), to apply the small companies regime may apply the Financial Reporting Standard for Smaller Entities (effective [January 2015]) (FRSSE), which includes all relevant extracts of company law, or may elect to apply either [draft] FRS 102, EU-adopted IFRS or, for financial statements that are the individual accounts of a qualifying entity, [draft] FRS 101. The definition of a small company is contained in sections 381–384 of the Act. The qualifying conditions are currently met by a company in a year in which it does not exceed two or more of the following criteria:

Turnover £6,500,000

Balance sheet total £3,260,000

Average number of employees 50.

* Broadly, those listed on a regulated market.

- A2.8 For any company, other than a newly incorporated company, to qualify as small, the qualifying conditions must be met for two consecutive years^{*}. A company will cease to qualify as small if it fails to meet the qualifying conditions for two consecutive years.
- A2.9 Certain companies are excluded by section 384 of the Act from the small companies' regime for reasons of public interest[†]. These companies are those that meet one of the following conditions or are part of an ineligible group, which is a group with a member meeting one of the conditions.
- (a) a public company;
 - (b) a company that is an authorised insurance company, a banking company, an e-money issuer, a MiFID investment firm or a UCITS management company or a company that carries on insurance market activity;
 - (c) a body corporate (other than a company) whose shares are admitted to trading on a regulated market in an EEA State; or
 - (d) a person (other than a small company) who has permission under Part 4 of the Financial Services and Markets Act 2000 to carry on a regulated activity.
- A2.10 A parent company shall not be treated as qualifying as a small company in relation to a financial year unless the group headed by it qualifies as a small group.
- A2.11 The definition of a small group is contained in section 383. The qualifying conditions are met by a group in a year in which it does not exceed two or more of the following criteria:
- Aggregate turnover £6,500,000 net (or £7,800,000 gross)
 - Aggregate balance sheet total £3,260,000 net (or £3,900,000 gross)
 - Aggregate number of employees 50.
- 'Net' means after any set-offs and other adjustments required by Schedule 6 of the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 in the case of group accounts, and 'gross' means without those set-offs and other adjustments. A company may satisfy the relevant requirements on the basis of either the net or the gross figure.

Financial reporting by charitable companies

- A2.12 Section 395(2) of the Act states that "the individual accounts of a company that is a charity must be Companies Act individual accounts", and section 403(3) of the Act mirrors this for a parent company that is a charity.

Moving between IAS accounts and Companies Act accounts

- A2.13 Both sections 395 and 403 of the Act provide that a company or group which prepares IAS accounts may not move to preparing Companies Act accounts unless there is a "relevant change in circumstance". This restriction is still applicable. The Department for Business, Innovation and Skills (BIS) is considering responses to its consultation[‡] on amending the Act so that the definition of a relevant change in circumstance includes the implementation of the

^{*} Although an entity will continue to qualify as small in the first financial year in which it does not meet the size criteria, if it qualified as small in the previous year.

[†] In addition, the FRSSE does not apply to:

- (a) companies preparing individual or group accounts in accordance with the fair value rules;
- (b) companies that are authorised insurance companies, banking companies, e-money issuers, MiFID investment firms, UCITS management companies or companies carrying on insurance market activity; and
- (c) persons with permission under Part 4 of the FSMA 2000 to carry on a regulated activity.

[‡] Consultation on Audit Exemptions and Change in Accounting Framework issued 6 October 2011.

proposals set out in this FRED. If the Act is amended, a subsidiary company (for example) which previously elected to prepare accounts under EU-adopted IFRS for consistency with its parent company will not be prohibited by the Act from applying [draft] FRS 101 or [draft] FRS 102.

Consistency of financial reporting within groups

A2.14 The Act requires, in section 407, that the individual accounts of a parent company and each of its subsidiaries are prepared using the same financial reporting framework, except to the extent that in the directors' opinion there are good reasons for not doing so.

In addition, consistency is not required in the following situations:

- (a) when the parent company does not prepare consolidated financial statements;
- (b) when some subsidiaries are charities (consistency is not needed between the framework used for these and for other subsidiaries); and
- (c) where the directors of a parent company prepare IAS consolidated financial statements and IAS individual accounts.

A2.15 All companies, other than those which elect or are required to prepare IAS accounts in accordance with law, prepare Companies Act accounts. As a consequence, it is possible for a group to meet the consistency requirement where some subsidiaries apply [draft] FRS 101 and others apply [draft] FRS 102.

APPLICABILITY OF UK COMPANY LAW TO ENTITIES PREPARING IAS ACCOUNTS

A2.16 Entities that voluntarily elect to prepare IAS accounts only need apply certain sections of the Act as it relates to financial reporting. They are not required to comply with Schedules 1 and 6 of the Regulations (for companies and groups), nor with Schedules 2 or 3 (for banks and insurance companies). Schedules 4, 5, 7 and 8 of the Regulations are, however, still applicable.

A2.17 The sections of parts 15 and 16 of the Act that contain financial reporting requirements applying to 'IAS accounts' (as well as to 'Companies Act accounts') are as follows:

- (a) Section 410A (disclosure of off balance sheet arrangements);
- (b) Section 411 (employee numbers and costs);
- (c) Section 412 (directors' benefits: remuneration);
- (d) Section 413 (loans and transactions with officers and directors);
- (e) Sections 415–419 (contents of directors' report);
- (f) Sections 420–421 (contents of directors' remuneration report); and
- (g) Section 494 (auditor's remuneration).

ENTITIES NOT SUBJECT TO COMPANY LAW

A2.18 Many entities that apply [draft] FRS 102 are not companies, but are nevertheless required by their governing legislation or other regulation or requirement, to prepare financial statements that present a true and fair view of the financial performance and financial position of the reporting entity. However, the ASB sets accounting standards within the framework of the Act and therefore it is the company law requirements that the ASB primarily considered when

developing [draft] FRS 102. Entities preparing financial statements within other legal frameworks will need to satisfy themselves that [draft] FRS 102 does not conflict with any relevant legal obligations.

A2.19 However, the ASB notes the following:

Legislation	Overview of requirements
Building Societies Act 1986	<p>The annual accounts of a building society shall give a true and fair of the income and expenditure for the year and the balance sheet shall give a true and fair view of the state of affairs of the society at the end of the financial year.</p> <p>Regulations make further requirements about the form and content of building society accounts, which do not appear inconsistent with the requirement of [draft] FRS 102.</p>
Charities Act 1993 (as amended by the Charities Act 2006) and regulations made thereunder	<p>All charities are required to prepare accounts. The regulations require financial statements (other than cash-based receipts and payments accounts prepared by smaller charities) to present a true and fair view of the incoming resources, application of resources and the balance sheet, and to be prepared in accordance with the SORP.</p> <p>The Charities SORP 2005 requires the application of accounting standards and is compatible with the legal requirements, clarifying how they apply to accounting by charities. The SORP will be updated to reflect the requirements of [draft] FRS 102.</p> <p>Company law prohibits charities from preparing IAS accounts.</p>
Friendly and Industrial and Provident Societies Act 1968	<p>Every Society shall prepare a revenue account and a balance sheet giving a true and fair view of the income and expenditure and state of affairs of the Society.</p> <p>[draft] FRS 102 does not appear to give rise to any legal conflicts for Societies. However, Societies often carry out activities that are regulated and may be required to comply with additional regulations on top of the legal requirements and accounting standards. Some Societies fall within the scope of SORPs, which will be updated to reflect the requirements of [draft] FRS 102.</p>

Legislation	Overview of requirements
<p>The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996</p>	<p>The accounts of pension funds within the scope of the regulations should show a true and fair view of the transactions during the year, assets held at the end of the year and liabilities of the scheme, other than those to pay pensions and benefits.</p> <p>[draft] FRS 102 includes pension funds as a specialised activity.</p>

APPENDIX III: DEVELOPMENT OF THE [DRAFT] FRS 100

A3.1 The development of the proposals in this [draft] FRS is set out in part III of FREDs 46 to 48.

A3.2 Paragraph 20 of this draft FRS sets out the withdrawal of current accounting standards. For the avoidance of doubt, the ASB will also not proceed with developing the following Financial Reporting Exposure Drafts (FREDs):

FRED 22 ‘Revision of FRS 3 ‘Reporting Financial Performance’

FRED 28 ‘Inventories: construction and service contracts’

FRED 29 ‘Property, plant and equipment: Borrowing costs’

FRED 32 ‘Disposal of non-current assets and presentation of discontinued operations’

FRED 36 ‘Business combinations’

FRED 37 ‘Intangible assets’ (IAS 38) and FRED 38 ‘Impairment of assets’ (IAS 36)

FRED 39 ‘Amendments to FRS 12 ‘Provisions, contingent liabilities and contingent assets’ and FRS 17 ‘Retirement benefits’

FRED 43 ‘Application of Financial Reporting Requirements’

FRED 44 ‘The Financial Reporting Standards for Smaller and Medium-sized Entities’

FRED 45 ‘The Financial Reporting Standard for Public Benefit Entities’

**REVISED FINANCIAL REPORTING
EXPOSURE DRAFT**

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**REDUCED DISCLOSURE FRAMEWORK
[DRAFT FRS 101]**

**Disclosure exemptions from EU-adopted IFRS
for qualifying entities**

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[DRAFT] SUMMARY

- 1 In 201[2] the Accounting Standards Board (ASB) revised financial reporting standards in the United Kingdom and Republic of Ireland. The revisions fundamentally reformed financial reporting, replacing extant standards with three [draft] Financial Reporting Standards:

FRS 100 ‘Application of Financial Reporting Requirements’;

FRS 101 ‘Reduced Disclosure Framework’; and

FRS 102 ‘The Financial Reporting Standard applicable in the UK and Republic of Ireland’.

- 2 The revisions made by the ASB followed a sustained and detailed period of consultation. The ASB made these fundamental changes recognising that the introduction of International Financial Reporting Standards for listed groups in 2002 (with application from 2005) called into question the need for two sets of financial reporting standards. Evidence from consultation supported a move towards an international based framework for financial reporting, but one that was proportionate to the needs of preparers and users.
- 3 The ASB’s objective is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and the users’ information needs.
- 4 In meeting its objective, the ASB aims to provide succinct financial reporting standards that:
 - have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;
 - reflect up-to-date thinking and developments in the way businesses operate and the transactions they undertake;
 - balance consistent principles for accounting by all UK and Republic of Ireland entities with pragmatic solutions, based on size, complexity, public interest and users’ information needs;
 - promote efficiency within groups; and
 - are cost-effective to apply.
- 5 This [draft] Financial Reporting Standard (FRS) sets out a reduced disclosure framework which addresses the financial reporting requirements and disclosure exemptions for the financial statements of subsidiaries and ultimate parents that otherwise apply the recognition, measurement and disclosure requirements of standards and interpretations issued (or adopted) by the International Accounting Standards Board that have been adopted in the European Union (EU-adopted IFRS). It is envisaged that the provision of these disclosure exemptions could result in cost savings in the preparation of financial statements of subsidiaries and ultimate parents, without reducing the quality of financial reporting.
- 6 Disclosure exemptions are available to a qualifying entity, as defined in the glossary to [draft] FRS 100, in its individual accounts (but not in any consolidated financial statements which it is required or voluntarily chooses to prepare). In particular:
 - (a) a qualifying entity which is not a financial institution, as defined in the glossary to [draft] FRS 100, may take advantage in its individual accounts of the disclosure exemptions set out in paragraphs 8–9 of this [draft] FRS (which include disclosure exemptions from IFRS 7 ‘Financial Instruments: Disclosures’ and IFRS 13 ‘Fair Value Measurement’). Where a qualifying entity has financial liabilities held at fair value which are neither held as part of a trading portfolio nor are derivatives, however, it must apply certain specific

disclosure requirements of IFRS 7 to those financial liabilities in order to meet legal requirements.

- (b) a qualifying entity which is a financial institution, as defined in the glossary to [draft] FRS 100, may take advantage in its individual accounts of the disclosure exemptions set out in paragraphs 8–9 of this [draft] FRS, other than the disclosure exemptions from IFRS 7 and IFRS 13.
- 7 A qualifying entity may apply the reduced disclosure framework regardless of whether the financial reporting framework applied in the consolidated financial statements of the group are based on standards and interpretations issued (or adopted) by the International Accounting Standards Board.
 - 8 Financial statements prepared by a qualifying entity in accordance with this [draft] FRS are not IAS individual accounts as defined in section 395(1)(b) of the Companies Act 2006 (Act), so the entity must make amendments to EU-adopted IFRS requirements where necessary, so that the financial statements that it prepares are Companies Act individual accounts as defined in section 395(1)(a) of the Act.
 - 9 The ASB decided on a set of principles for determining which of the disclosure requirements in IFRS should be applied by qualifying entities, to provide a structure for future amendments to the reduced disclosure framework. The agreed principles are ‘relevance’, ‘cost constraint on useful financial reporting’ and ‘avoid gold plating’, and they are explained in the section on the Development of the [draft] FRS.
 - 10 A reduced disclosure framework is also available to qualifying entities applying the recognition and measurement principles of [draft] FRS 102; the relevant financial reporting requirements and disclosure exemptions are set out in that standard.

[DRAFT] FINANCIAL REPORTING STANDARD 101: REDUCED DISCLOSURE FRAMEWORK

OBJECTIVE

- 1 The objective of this [draft] Financial Reporting Standard (FRS) is to set out the financial reporting requirements and disclosure exemptions (a reduced disclosure framework) for the financial statements of subsidiaries and ultimate parents that otherwise apply the recognition, measurement and disclosure requirements of standards and interpretations issued (or adopted) by the International Accounting Standards Board that have been adopted in the European Union.

SCOPE

- 2 This [draft] FRS applies to the financial statements of a qualifying entity, as defined in the glossary to [draft] FRS 100 'Application of Financial Reporting Requirements', that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income and expenditure) for a period.

ABBREVIATIONS AND DEFINITIONS

- 3 The terms **Act**, **EU-adopted IFRS**, **[draft] FRS 100**, **[draft] FRS 101**, **[draft] FRS 102**, **FRSSE**, **IAS Regulation**, **IFRS**, **individual accounts**, **Regulations** and **SORP** are explained in the glossary included as Appendix I to [draft] FRS 100 'Application of Financial Reporting Requirements'.

REDUCED DISCLOSURES FOR SUBSIDIARIES AND ULTIMATE PARENTS

- 4 A qualifying entity which is not a financial institution may take advantage in its individual accounts of the disclosure exemptions set out in paragraphs 8-9 of this [draft] FRS. Where a qualifying entity has financial liabilities held at fair value which are neither held as part of a trading portfolio nor are derivatives, however, it must apply the disclosure requirements of paragraphs 8(e), 10, 11, 17, 20(a)(i), 25, 26, 27, 27A, 28, 29, 30 of IFRS 7 to those financial liabilities*.
- 5 A qualifying entity which is a financial institution may take advantage in its individual accounts of the disclosure exemptions set out in paragraphs 8-9 of this [draft] FRS, other than the disclosure exemptions from 'IFRS 7 Financial Instruments: Disclosures' and IFRS 13 'Fair Value Measurement'.
- 6 A qualifying entity which is required to prepare consolidated financial statements (for example, if the entity is required by section 399 of the Act to prepare group accounts, and is not entitled to any of the exemptions in sections 400-402 of the Act), or which voluntarily chooses to do so, may not apply this [draft] FRS in its consolidated financial statements.
- 7 A qualifying entity may take advantage of the disclosure exemptions in paragraphs 8-9 of this [draft] FRS, in accordance with paragraphs 4-6 of this [draft] FRS, only if:
 - (a) its shareholders have been notified in writing about, and do not object to, the use of the disclosure exemptions. A shareholder may object to the use of the disclosure exemptions only if the shareholder is the immediate parent of the entity, or if the shareholder holds more than half of the allotted shares in the entity that are not held by the immediate parent, or if the shareholder holds 5% or more of the total allotted shares in the entity;

* Paragraph 36(4) of Schedule 1 to the Regulations. (Note, however, that the requirements in paragraph 4 are applicable to public benefit entities and other entities that are a qualifying entity, not just to companies that are a qualifying entity.)

- (b) it otherwise applies the recognition, measurement and disclosure requirements of EU-adopted IFRS, but makes amendments to EU-adopted IFRS requirements where necessary in order to comply with the Act and the Regulations, so that the financial statements that it prepares are Companies Act individual accounts as defined in section 395(1)(a) of the Act, not IAS individual accounts as defined in section 395(1)(b) of the Act. Application Guidance I to this [draft] FRS sets out the necessary amendments; and
 - (c) it states in the notes to its financial statements:
 - (i) the relevant standard and paragraph references of the exemptions adopted; and
 - (ii) the name of the parent in whose consolidated financial statements its financial statements are consolidated, and from where those financial statements may be obtained.
- 8 A qualifying entity may take advantage of the following disclosure exemptions, from when the relevant standard is applied:
- (a) the requirements of paragraphs 45(b) and 46–52 of IFRS 2 ‘Share based Payment’, except for a group arrangement involving equity instruments of an entity other than the parent, providing equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated;
 - (b) the requirements of paragraphs B64(d), B64(e), B64(g), B64(h), B64(j)–B64(m), B64(n)(ii), B64(o)(ii), B64(p), B64(q), B66 and B67 of IFRS 3 ‘Business Combinations’ (for the acquisition of a group of assets that constitute a business), providing equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated;
 - (c) the requirements of paragraph 33(b) and 33(c) of IFRS 5 ‘Non-current Assets Held for Sale and Discontinued Operations’, providing equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated;
 - (d) the requirements of IFRS 7 ‘Financial Instruments: Disclosures’ providing equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated;
 - (e) the requirements of paragraphs 91–99 of IFRS 13 ‘Fair Value Measurement’, providing equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated;
 - (f) the requirement in paragraph 38 of IAS 1 ‘Presentation of Financial Statements’ to present comparative information in respect of:
 - (i) paragraph 73(e) of IAS 16 ‘Property, Plant and Equipment’; and
 - (ii) paragraph 118(e) of IAS 38 ‘Intangible Assets’; and
 - (iii) paragraphs 76 and 79(d) of IAS 40 ‘Investment Property’;
 - (g) the requirements of paragraphs 10(d), 10(f), 39(c) and 134–136 of IAS 1 ‘Presentation of Financial Statements’; in addition, the reference to IAS 1 in paragraph 21 of IFRS 1 ‘First-time Adoption of International Financial Reporting Standards’ may be ignored;
 - (h) the requirements of IAS 7 ‘Statement of Cash Flows’;
 - (i) the requirements of paragraphs 30 and 31 of IAS 8 ‘Accounting Policies, Changes in Accounting Estimates and Errors’;

- (j) the requirements of paragraph 74(c) of IAS 16 'Property, Plant and Equipment';
 - (k) the requirements of paragraph 17 of IAS 24 'Related Party Disclosures';
 - (l) the requirements in IAS 24 'Related Party Disclosures' to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by a member of that group;
 - (m) the requirements of paragraphs 134(d)-134(f) and 135(c)-135(e) of IAS 36 'Impairment of Assets', providing equivalent disclosures are included in the consolidated financial statements of the parent in which the entity is consolidated; and
 - (n) the requirements of paragraph 122(e) of IAS 38 'Intangible Assets'.
- 9 Reference should be made to the Application Guidance to [draft] FRS 100 in deciding whether the consolidated financial statements of the parent provide disclosures which are equivalent to the requirements of EU-adopted IFRS, from which relief is provided in paragraph 8 of this [draft] FRS.

DATE FROM WHICH EFFECTIVE AND TRANSITIONAL ARRANGEMENTS

- 10 An entity may apply this [draft] FRS for accounting periods beginning on or after [1 January 2015]. Early application is permitted for accounting periods beginning on or after the date of issue of this standard, subject to the additional requirement for a public benefit entity that it must also apply a public benefit entity SORP which has been developed in accordance with this [draft] FRS, [draft] FRS 100 and [draft] FRS 102.

APPLICATION GUIDANCE I: AMENDMENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS AS ADOPTED IN THE EUROPEAN UNION FOR COMPLIANCE WITH THE ACT AND THE REGULATIONS*

This application guidance forms an integral part of [draft] FRS 101

AG1 In accordance with the Act, an entity may prepare Companies Act individual accounts or IFRS individual accounts. A qualifying entity which applies [draft] FRS 101 prepares Companies Act individual accounts. This Application Guidance to [draft] FRS 101 sets out the amendments to EU-adopted IFRS to achieve compliance with the Act and related Regulations (deleted text is struck through and underlined text is inserted):

- (a) Paragraph D16 of IFRS 1 'First-time Adoption of International Financial Reporting Standards' is amended as follows:

If a subsidiary becomes a first-time adopter later than its parent, the subsidiary shall, in its financial statements, measure its assets and liabilities at either:

- (a) the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary; or
- (b) the carrying amounts required by the rest of this IFRS, based on the subsidiary's date of transition to IFRSs. These carrying amounts could differ from those described in (a):
 - (i) when the exemptions in this IFRS result in measurements that depend on the date of transition to IFRSs;
 - (ii) when the accounting policies used in the subsidiary's financial statements differ from those in the consolidated financial statements. For example, the subsidiary may use as its accounting policy the cost model in IAS 16 Property, Plant and Equipment, whereas the group 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.

This election is available to a qualifying entity provided that it is a subsidiary that measures its assets and liabilities in compliance with the Act in accordance with the reduced disclosure framework set out in the [draft] Financial Reporting Standard 101 'Reduced Disclosure Framework'.

- (b) Paragraph D17 of IFRS 1 'First-time Adoption of International Financial Reporting Standards' is amended as follows:

However, if an entity becomes a first-time adopter later than its subsidiary (or associate or joint venture) the entity shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary (or associate or joint venture) at the same carrying amounts as in the financial statements of the subsidiary (or associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary. Similarly, if a parent becomes a

* The requirements in this section are applicable to public benefit entities and other entities, not just to companies.

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 on both financial statements, except for consolidation adjustments.

This election is available to a qualifying entity provided that it is a parent that measures its assets and liabilities in compliance with the Act in accordance with the reduced disclosure framework set out in [draft] Financial Reporting Standard 101 'Reduced Disclosure Framework'.

- (c) Paragraph 34 of IFRS 3 'Business Combinations' is amended as follows:

Occasionally, an acquirer will make a bargain purchase, which is a business combination in which the amount in paragraph 32(b) exceeds the aggregate of the amounts specified in paragraph 32(a). If that excess remains after applying the requirements in paragraph 36, the acquirer shall recognise the resulting ~~gain in profit or loss~~ excess on the face of the statement of financial position on the acquisition date, immediately below the intangible assets heading as a negative asset, and followed by a subtotal showing the net amount of the intangible assets and the negative asset. The ~~gain-negative asset~~ shall be attributed to the acquirer. The amount of the negative asset up to the fair values of the non-monetary assets acquired should be recognised in the statement of profit or loss in the periods in which the non-monetary assets are recovered, whether through depreciation or sale. Any amount of the negative asset in excess of the fair values of the non-monetary assets acquired should be recognised in profit or loss in the periods expected to be benefited.

- (d) Paragraph 33 of IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations' is amended as follows:

An entity shall disclose:

- (a) a single amount in the statement of comprehensive income comprising the total of:
 - (i) the post-tax profit or loss of discontinued operations; and
 - (ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.
- (b) an analysis of the single amount in (a) into:
 - (i) the revenue, expenses and pre-tax profit or loss of discontinued operations;
 - (ii) the related income tax expense as required by paragraph 81(h) of IAS 12;
 - (iii) the gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation; and
 - (iv) the related income tax expense as required by paragraph 81(h) of IAS 12.

The analysis ~~may be~~ is presented ~~in the notes or~~ in the statement of comprehensive income. ~~If it is presented~~ In the statement of comprehensive income it shall be presented in a ~~section~~ column identified as relating to discontinued operations, ie separately from continuing operations; a total column should also be presented. The analysis is not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition (see paragraph 11).

- (c) the net cash flows attributable to the operating, investing and financing activities of discontinued operations. These disclosures may be presented either in the notes or in

the financial statements. These disclosures are not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition (see paragraph 11).

- (d) the amount of income from continuing operations and from discontinued operations attributable to owners of the parent. These disclosures ~~may be~~ are presented ~~either in the notes or~~ in the statement of comprehensive income.
- (e) Paragraph 60 of IAS 1 'Presentation of Financial Statements' is amended as follows:

An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position in accordance with paragraphs 66-76 ~~except when a presentation based on liquidity provides information that is reliable and more relevant. When that exception applies, an entity shall present all assets and liabilities in order of liquidity.~~ An entity within the scope of Schedule 2 of the Regulations should use a format set out in that Schedule.

- (f) Paragraph 61 of IAS 1 'Presentation of Financial Statements' is amended as follows:

~~Whichever method of presentation is adopted,~~ An entity shall disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability line item that combines amounts expected to be recovered or settled:

- (a) no more than twelve months after the reporting period, and
- (b) more than twelve months after the reporting period.
- (g) Paragraph 87 of IAS 1 Presentation of Financial Statements is amended as follows:

~~An entity shall not present any items of income or expense as extraordinary items, in the statement of comprehensive income or the separate income statement (if presented), or in the notes.~~

Ordinary activities are any activities which are undertaken by a reporting entity as part of its business and such related activities in which the reporting entity engages in furtherance of, incidental to, or arising from, these activities. Ordinary activities include any effects on the reporting entity of any event in the various environments in which it operates, including the political, regulatory, economic and geographical environments, irrespective of the frequency or unusual nature of the events.

87A Extraordinary items are material items possessing a high degree of abnormality which arise from events or transactions that fall outside the ordinary activities of the reporting entity and which are not expected to recur. They do not include items occurring within the entity's ordinary activities which individually or, if of a similar type, in aggregate, need to be disclosed by virtue of their size or incidence if the financial statements are to give a true and fair view, nor do they include prior period items merely because they relate to a prior period.

- (h) Paragraph 28 of IAS 16 'Property, Plant and Equipment' is deleted.
- (i) Paragraph 116 of IAS 19 'Employee Benefits' is amended as follows:

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) recognise its right to reimbursement as a separate asset. The entity shall measure the asset at fair value.

- (b) disaggregate and recognise 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 124 and 125). ~~The components of defined benefit cost recognised in accordance with paragraph 120 may be recognised net of amounts relating to changes in the carrying amount of the right to reimbursement.~~
- (j) Paragraph 24 of IAS 20 ‘Accounting for Government Grants and Disclosure of Government Assistance’ is amended as follows:
- Government grants related to assets, including non-monetary grants at fair value, shall be presented in the statement of financial position ~~either~~ by setting up the grant as deferred income ~~or by deducting the grant in arriving at the carrying amount of the asset.~~
- (k) Paragraph 25 of IAS 20 ‘Accounting for Government Grants and Disclosure of Government Assistance’ is deleted.
- (l) Paragraph 26 of IAS 20 ‘Accounting for Government Grants and Disclosure of Government Assistance’ is amended as follows:
- ~~One method recognises~~ The grant is recognised as deferred income that is recognised in profit or loss on a systematic basis over the useful life of the asset.
- (m) Paragraph 27 of IAS 20 ‘Accounting for Government Grants and Disclosure of Government Assistance’ is deleted.
- (n) Paragraph 28 of IAS 20 ‘Accounting for Government Grants and Disclosure of Government Assistance’ is amended as follows:
- The purchase of assets and the receipt of related grants can cause major movements in the cash flow of an entity. For this reason and in order to show the gross investment in assets, such movements are ~~often~~ disclosed as separate items in the statement of cash flows ~~regardless of whether or not the grant is deducted from the related asset for presentation purposes in the statement of financial position.~~
- (o) Paragraph 29 of IAS 20 ‘Accounting for Government Grants and Disclosure of Government Assistance’ is amended as follows:
- Grants related to income are ~~sometimes~~ presented as a credit in the statement of comprehensive income, ~~either~~ separately or under a general heading such as ‘Other income’; ~~alternatively, they are deducted in reporting the related expense.~~
- (p) Paragraph 13 of IAS 23 ‘Borrowing Costs’ is deleted.
- (q) Paragraph 124 of IAS 36 ‘Impairment of Assets’ is amended as follows:
- An impairment loss recognised for goodwill shall ~~not~~ be reversed in a subsequent period if and only if the reasons for the impairment loss have ceased to apply.

APPENDIX I: NOTE ON LEGAL REQUIREMENTS

INTRODUCTION

- A1.1 This [draft] appendix provides an overview of how the proposals set out in this FRED address United Kingdom and Republic of Ireland company law requirements. It is therefore written from the perspective of a company to which the Companies Act 2006 applies. Specific legal requirements in the Republic of Ireland are available on the ASB website (www.frc.org.uk/asb).
- A1.2 Reference to the Act in this Appendix refers to the Companies Act 2006. Reference to the Regulations refers to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. References to specific provisions are to Schedule 1 to the Regulations; entities applying Schedules 2 or 3 should read them as referring to the equivalent paragraph in those schedules.

COMPANIES ACT ACCOUNTS

- A1.3 Accounts prepared in accordance with standards and interpretations issued (or adopted) by the International Accounting Standards Board that have been adopted in the European Union (EU-adopted IFRS) are 'IAS accounts', and are within the scope of EU Regulation 1606/2002 (IAS Regulation). All other accounts are classified as 'Companies Act accounts', including those of qualifying entities applying this [draft] FRS, and are therefore required to comply with the provisions of Part 15 of the Act and with the Regulations.

APPLICABLE ACCOUNTING FRAMEWORK

Consistency of financial reporting within groups

- A1.4 The Act requires, in section 407, that the individual accounts of a parent company and each of its subsidiaries are prepared using the same financial reporting framework, except to the extent that in the directors' opinion there are good reasons for not doing so.

In addition, consistency is not required in the following situations:

- (a) when the parent company does not prepare consolidated financial statements;
 - (b) when some subsidiaries are charities (consistency is not needed between the framework used for these and for other subsidiaries); and
 - (c) where the directors of a parent company prepare IAS consolidated financial statements and IAS individual accounts.
- A1.5 All companies, other than those which elect or are required to prepare IAS accounts in accordance with law, prepare Companies Act accounts. As a consequence, it is possible for a group to meet the consistency requirement where some subsidiaries apply this [draft] FRS and others apply [draft] FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'.

FINANCIAL INSTRUMENTS

A1.6 All preparers of Companies Act accounts must comply with the prescriptive requirements of paragraph 36 of Schedule 1 to the Regulations*, which provides that:

- (1) Subject to sub-paragraphs (2) to (5), financial instruments (including derivatives) may be included at fair value.
- (2) Sub-paragraph (1) does not apply to financial instruments that constitute liabilities unless—
 - a. they are held as part of a trading portfolio,
 - b. they are derivatives, or
 - c. they are financial instruments falling within sub-paragraph (4).
- (3) [...]
- (4) Financial instruments that, under international accounting standards adopted by the European Commission on or before 5th September 2006 in accordance with the IAS Regulation, may be included in accounts at fair value, may be so included, provided that the disclosure required by such accounting standards are made.
- (5) [...]

A1.7 A subsidiary applying EU-adopted IFRS and taking advantage of the reduced disclosure framework in [draft] FRS 101 must also comply with paragraph 36(4) as quoted above, and therefore all relevant IAS disclosures are required for financial instruments that are liabilities included at fair value, except those held as part of a trading portfolio or derivatives.

APPLICATION OF THE REDUCED DISCLOSURE FRAMEWORK PROPOSALS

A1.8 Where a qualifying entity prepares accounts in accordance with [draft] FRS 101, it prepares Companies Act individual accounts as referred to in section 395 of the Act. These accounts must comply with the provisions of section 396 of the Act and, by extension, with the Regulations. This includes compliance with the required formats for accounts as set out in the Regulations:

- (a) qualifying entities should have regard to the Appendix to Section 5 of [draft] FRS 102 ‘The Financial Reporting Standard applicable in the UK and Republic of Ireland’ when presenting discontinued operations.
- (b) for the Statement of Financial Position there is a high degree of correlation between the balance sheet format set out in the Regulations and the line items specified in IAS 1. However, IAS 1 is predicated on the basis of a ‘current/non-current distinction’, which is not always consistent with the ‘fixed assets; current assets; creditors: due within one year; creditors: due after more than one year; provisions for liabilities’ presentation set out in the Regulations. For example, qualifying entities will need to exercise care around the presentation of long term debtors, deferred tax and provisions to ensure compliance with company law; the presentation in their individual accounts may be different from that prepared for group consolidation purposes in accordance with EU-adopted IFRS.

* *The Small Companies and Groups (Accounts and Directors’ Report) Regulations 2008 (SI 2008/409) contain an identical provision for companies subject to the small companies’ regime.*

- A1.9 To ensure compliance with the Regulations (and therefore the EU Accounting Directives on which they are based) an analysis was undertaken of EU-adopted IFRS (extant in 2011) to identify any areas in EU-adopted IFRS not compliant with the Regulations. Based on this analysis, certain requirements of EU-adopted IFRS are incompatible with the Regulations and any entity taking advantage of the reduced disclosure framework will need to ensure that it has made appropriate amendments to its EU-adopted IFRS accounting policies and practices to ensure compliance with the Regulations. The amendments are set out in the Application Guidance. Table I at the end of this Appendix sets out more details of the areas where EU-adopted IFRS will need amendment in order to ensure compliance with the Accounting Directives. The situations described are not considered likely to be common in practice.

Non-amortisation of goodwill

- A1.10 A qualifying entity preparing accounts in accordance with [draft] FRS 101 may have recognised goodwill which, in accordance with IFRS 3, is not amortised. The non-amortisation of goodwill conflicts with paragraph 22 of Schedule 1 to the Regulations, which requires acquired goodwill to be reduced by provisions for depreciation calculated to write off the amount systematically over a period chosen by the directors, not exceeding its useful economic life. As such, the non-amortisation of goodwill will usually be a departure, for the overriding purpose of giving a true and fair view, from the requirement of paragraph 22 of Schedule 1 to the Regulations. In this circumstance there will need to be given in the notes to the accounts “particulars of the departure, the reasons for it and its effect” (paragraph 10(2) of Schedule 1 to the Regulations). This is not a new instance of the use of the ‘true and fair override’ as FRS 10 ‘Goodwill and intangible assets’ paragraph 18 noted that it would have been required by companies applying FRS 10.17 which states: “Where goodwill and intangible assets are regarded as having indefinite useful economic lives, they should not be amortised.”

Long-term debtors

- A1.11 Preparers should also continue to note the distinction between ‘fixed assets’* (the term used in the Regulations) and ‘non-current assets’ (from EU-adopted IFRS). UITF Abstract 4 addressed the inclusion of debtors due after more than one year within ‘current assets’: that UITF consensus remains valid and is reproduced below.
- A1.12 In most cases it will be satisfactory to disclose the size of debtors due after more than one year in the notes to the accounts. There will be some instances, however, where the amount is so material in the context of the total net current assets that in the absence of disclosure of the debtors due after more than one year on the face of the balance sheet readers may misinterpret the accounts. In such circumstances, the amount should be disclosed on the face of the balance sheet within current assets.
- A1.13 A qualifying entity preparing accounts in accordance with [draft] FRS 101 will need to pay attention to the interaction of the Act and IAS 1 ‘Presentation of financial statements’ in respect of accounts formats and may report long-term debtors differently in its own accounts from that included in its parent’s consolidated accounts prepared in accordance with EU-adopted IFRS (ie in current assets rather than non-current assets).

* Assets of an entity which are intended for use on a continuing basis in the entity’s activities.

Table I – Areas for consideration by a qualifying entity preparing accounts in accordance with FRS 101 ‘Reduced Disclosure Framework’, in order to ensure compliance with the Accounting Directives

IFRS	Explanation/potential issues	Proposal in this FRED
IFRS 1	<p><i>Assets and liabilities of subsidiaries, associates and joint ventures.</i></p> <p>IFRS 1 provides an option for a subsidiary which becomes a first-time adopter later than its parent or for an associate or joint venture that becomes a first-time adopter later than an entity that has significant influence or joint control over it. This option allows the entity to measure its assets and liabilities at the carrying amounts that would be included in the parent’s consolidated financial statements, based on the parent’s date of transition to IFRS (D16). Due to the amendments which are necessary to ensure compliance with the EU-directives, subsidiaries applying [draft] FRS 101 should take care in considering this option because they must measure their assets and liabilities in accordance with their own transition date. Using the amounts based on those included in the parent’s consolidated financial statements may not be compliant with the Directives.</p> <p>IFRS 1 requires that, where an entity becomes a first-time adopter later than its subsidiary, the entity shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary at the same carrying amounts as in the individual financial statements of the subsidiary (D17). However, in order to comply with the Accounting Directives, where the subsidiary financial statements are prepared in accordance with [draft] FRS 101, the assets and liabilities of the subsidiary may be measured differently to the amounts included in the consolidated financial statements which are measured in accordance with EU-adopted IFRS.</p>	<p>Propose to allow option, provided that the measurement of assets and liabilities in the subsidiary’s individual accounts comply with the Accounting Directives.</p> <p>Propose to allow option, provided that the measurement of assets and liabilities in the parent’s individual accounts comply with the Accounting Directives.</p>
IFRS 3	<p><i>Negative goodwill.</i></p> <p>IFRS 3 requires that negative goodwill is recognised as a gain in profit or loss at the acquisition date (IFRS 3.34). However, the 7th Directive sets out conditions for the recognition of negative goodwill in profit or loss (Art 31).</p>	<p>Propose to amend IFRS 3.34 in line with the amendments made to IFRS for SMEs 19.24.</p>

IFRS	Explanation/potential issues	Proposal in this FRED
IFRS 5	<p><i>Analysis of results of discontinued operation.</i></p> <p>IFRS 5 allows this analysis to be presented on the face of the statement of comprehensive income or in the notes (IFRS 5.33). Under the 4th Directive, Art 23-26, this information must be provided on the face of the profit and loss account (or equivalent) in order to provide appropriate totals, in relation to ordinary activities, for certain line items. Therefore the option of providing this analysis in the notes is not compliant with the 4th Directive.</p>	<p>Propose to amend IFRS 5.33 to remove the option to present the analysis in the notes to the accounts, and instead require the information to be given on the face of the statement of comprehensive income.</p>
IAS 1	<p>Balance sheet and Statement of Comprehensive income must comply with company law formats.</p> <p><i>Presentation based on liquidity.</i></p> <p>IAS 1.60 permits a balance sheet to be presented based on liquidity where this presentation provides information that is reliable and more relevant. However, under the Directives this option can only be used by banks and other financial institutions.</p> <p><i>Extraordinary items.</i></p> <p>IAS 1 does not permit the presentation of extraordinary items (IAS 1.87), however the 4th Directive requires it (Art 23-26).</p>	<p>For entities other than banks and other financial institutions, propose to remove the option in IAS 1.60 to present a balance sheet based on liquidity.</p> <p>Propose to amend IAS 1.87 to remove prohibition and introduce the definition of extraordinary items from FRS 3, as for IFRS for SMEs 5.10 of the IFRS for SMEs.</p>
IAS 16	<p><i>Government grants.</i></p> <p>IAS 16.28 permits the carrying amount of property, plant and equipment to be reduced by government grants in accordance with IAS 20. Such off-setting is not permitted under the 4th Directive (Art 7). Therefore this option is not compliant.</p>	<p>Propose to amend IAS 16.28 to remove the option to reduce the carrying amount of property, plant and equipment by government grants.</p>
IAS 19	<p><i>Reimbursement.</i></p> <p>IAS 19.116(b) permits the expense relating to defined benefit plan to be presented in the statement of comprehensive income net of the amount recognised for a reimbursement. However, Art 7 of the 4th Directive does not permit set-off between income and expenditure items.</p>	<p>Propose to remove the off-setting option in IAS 19.116(b).</p>

IFRS	Explanation/potential issues	Proposal in this FRED
IAS 20	<p><i>Balance sheet off-setting.</i> IAS 20.24 contains an option which permits government grants related to assets to be deducted in arriving at the carrying amount of the asset. Such off-setting of assets and liabilities is not permitted by Art 7 of the 4th Directive.</p> <p><i>Profit and loss account off-setting.</i> IAS 20.29 contains an option which permits grants related to income to be deducted in reporting the related expense. Such off-setting of income and expenditure is not permitted by Art 7 of the 4th Directive.</p>	<p>Propose to amend IAS 20.24 to remove the off-set option.</p> <p>Propose to amend IAS 20.29 to remove the off-set option.</p>
IAS 36	<p><i>Reversal of impairment of goodwill.</i> IAS 36 prohibits the reversal of impairment losses recognised on goodwill (IAS 36.124), while the 4th Directive requires it (Art 35) where the reasons for which they were recognised cease to apply.</p>	<p>Propose to amend IAS 36.124 in the same way as proposed for IFRS for SMEs 27.28.</p>

APPENDIX II: THE DEVELOPMENT OF THE [DRAFT] FRS 101

INTRODUCTION

- A2.1 This appendix provides an overview of the significant developments which have influenced the evolution of FRED 43 into its current form as [draft] FRS 100 and [draft] FRS 101 (FREDs 46 and 47 respectively).

THE SCOPE OF THE REDUCED DISCLOSURE FRAMEWORK

- A2.2 The Accounting Standards Board (ASB) decided that the scope of the reduced disclosure framework should be extended beyond subsidiaries so that the ultimate parent of a group may take advantage of the disclosure exemptions in its individual accounts. Intermediate parents are subsidiaries and so were already included within the scope of the reduced disclosure framework.
- A2.3 The ASB decided, in clarifying the scope of the reduced disclosure framework, that a qualifying entity which is required to prepare consolidated financial statements (for example, if the entity is required by section 399 of the Act to prepare group accounts, and is not entitled to any of the exemptions in sections 400–402 of the Act), or a qualifying entity which voluntarily chooses to prepare consolidated financial statements, should not be permitted to apply the reduced disclosure framework in its consolidated financial statements. The ASB recognised that entities which are required or voluntarily choose to prepare consolidated financial statements generally have users with greater information requirements than the users of entities which only prepare individual accounts. The reduced disclosure framework was originally developed with the objective of simplifying the disclosure requirements in the individual accounts of subsidiaries of groups, and the ASB did not wish to complicate that objective by extending it to include amendments to EU-adopted IFRS which are specific to consolidated financial statements.

THE REDUCED DISCLOSURE FRAMEWORK PRINCIPLES

- A2.4 The ASB also decided on a set of principles for determining which of the disclosure requirements in IFRS should be applied by qualifying entities, to provide a structure for future amendments to the reduced disclosure framework. The principles are specific to qualifying entities, so the impact on preparers and users of qualifying entity individual accounts is a common theme to be considered in applying the principles. The agreed principles are as follows:

1. *Relevance:*

Does the disclosure requirement provide information that is capable of making a difference to the decisions made by the users of the financial statements of a qualifying entity?

2. *Cost constraint on useful financial reporting:*

Does the disclosure requirement impose costs on the preparers of the financial statements of a qualifying entity that are not justified by the benefits to the users of those financial statements?

3. *Avoid gold plating:*

Does the disclosure requirement override an existing exemption provided by company law in the UK?

RELATED PARTY EXEMPTION FOR THE REDUCED DISCLOSURE FRAMEWORK

- A2.5 The ASB decided to include an exemption in the reduced disclosure framework from disclosing a related party transaction in accordance with IAS 24 'Related Party Disclosures' where the related party transaction was entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by a member of that group. The exemption set out in paragraph 8(l) of [draft] FRS 101 should only be applied where all subsidiaries which are a party to the transaction are wholly owned by a member of the group. The provision of this exemption is in line with principle 3 in paragraph A2.4; the ASB's rationale for its decision is set out in the Development of the Exposure Draft.

EXTENSION OF THE REDUCED DISCLOSURE FRAMEWORK TO RECENTLY ISSUED INTERNATIONAL FINANCIAL REPORTING STANDARDS AND AMENDMENTS

- A2.6 The ASB considered when and how the reduced disclosure framework should be extended to IFRS 9 'Financial Instruments', IFRS 10 'Consolidated Financial Statements', IFRS 11 'Joint Arrangements', IFRS 12 'Disclosure of Interests in Other Entities', IFRS 13 'Fair Value Measurement', IAS 1 'Presentation of Financial Statements' (as revised in 2011), IAS 19 'Employee Benefits' (as revised in 2011), IAS 27 'Separate Financial Statements' (as revised in 2011) and IAS 28 'Investments in Associates and Joint Ventures' (as revised in 2011).
- A2.7 The ASB decided that the reduced disclosure framework should be extended to recently issued International Financial Reporting Standards and Amendments when the relevant International Financial Reporting Standard or Amendment is applied. Subject to European endorsement, this will enable a group that applies EU-adopted IFRS in its consolidated financial statements to apply consistent recognition and measurement principles in the individual accounts of its parent and subsidiaries without also applying disclosure requirements that are suitable for consolidated financial statements and not those individual accounts.
- A2.8 The ASB decided that there should be no disclosure exemptions from IAS 19 (as revised in 2011) for qualifying entities. It noted that paragraph 150 of IAS 19 already provides entities which are not the sponsoring employer of a pension plan (see paragraph 41 of IAS 19) with considerable relief from making disclosures, and the ASB decided not to provide relief beyond that in the standard itself. The disclosure requirements in IAS 19 are considered to be relevant and cost beneficial for qualifying entities, and it is noted that the disclosure exemptions proposed in FRED 43 in relation to the superseded IAS 19 went beyond agreed guidelines.
- A2.9 The disclosure requirements of IAS 27 (as revised in 2011) concern separate financial statements and so were put together with those financial statements in mind; they are considered to be relevant to qualifying entities. IAS 28 (as revised in 2011), IFRS 9, IFRS 10 and IFRS 11 do not specify disclosure requirements, so no disclosure exemptions are proposed. Only the requirements of paragraphs 6 ('Scope' of the standard) and 24-31 ('Interests in unconsolidated structured entities') of IFRS 12 are considered to be relevant to qualifying entities, but no disclosure exemptions from IFRS 12 are necessary because they have already been provided by paragraph 6(b) of IFRS 12. The ASB is seeking views on the inclusion of an exemption in the reduced disclosure framework from the disclosure requirements of IFRS 13 for qualifying entities which are not financial institutions, but not for qualifying entities which are financial institutions, which is consistent with the disclosure exemptions provided for IFRS 7; a possible alternative for financial institutions would be to provide an exemption in individual accounts from all of IFRS 7 except for paragraphs 6, 7, 9(b), 16, 27A, 31, 33, 36, 37, 38, 39, 40 and 41 (this would provide consistency with disclosures required by FRED 48 for financial institutions, that is paragraphs 34.27 to 34.38 of FRED 48), and from paragraphs 92-99 of IFRS 13 (all disclosure requirements except the disclosure objectives).

**FINANCIAL REPORTING
EXPOSURE DRAFT**

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**THE FINANCIAL REPORTING STANDARD
applicable in the UK and Republic of Ireland
[DRAFT FRS 102]**

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The *Financial Reporting Standard (FRS)* is set out in Sections 1–35 and the Glossary. Terms defined in the Glossary are in **bold type** the first time they appear in each section.

SUMMARY

- 1 In 201[2] the Accounting Standards Board (ASB) revised financial reporting standards in the United Kingdom and Republic of Ireland. The revisions fundamentally reformed financial reporting, replacing extant standards with three [draft] Financial Reporting Standards:

FRS 100 ‘Application of Financial Reporting Requirements’;

FRS 101 ‘Reduced Disclosure Framework’; and

FRS 102 ‘The Financial Reporting Standard applicable in the UK and Republic of Ireland’

- 2 The revisions made by the ASB followed a sustained and detailed period of consultation. The ASB made these fundamental changes recognising that the introduction of International Financial Reporting Standards for listed groups in 2002 (with application from 2005) called into question the need for two sets of financial reporting standards. Evidence from consultation supported a move towards an international based framework for financial reporting, but one that was proportionate to the needs of preparers and users.
- 3 The ASB’s objective is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and the users’ information needs.
- 4 In meeting its objective the ASB will provide succinct financial reporting standards that:
 - have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;
 - reflect up-to-date thinking and developments in the way businesses operate and the transactions they undertake;
 - balance consistent principles for accounting by all UK and Republic of Ireland entities with pragmatic solutions, based on size, complexity, public interest and users’ information needs;
 - promote efficiency within groups; and
 - are cost-effective to apply.
- 5 The requirements in this [draft] Financial Reporting Standard (FRS) take into consideration the findings from the previous consultations on the future of financial reporting in the UK and Republic of Ireland.
- 6 [draft] FRS 100 sets out financial reporting requirements which are dependent on the status of the entity (and not that of its parent). An entity that is required by EU Regulation 1606/2002 (or other legislation or regulation) to prepare consolidated financial statements in accordance with standards and interpretations issued (or adopted) by the International Accounting Standards Board that have been adopted in the European Union (EU-adopted IFRS) must do so. The individual accounts of such an entity, or the individual accounts or consolidated financial statements of any other entity within the scope of [draft] FRS 100, must be prepared in accordance with the following requirements:
 - (a) If the entity is eligible to apply the Financial Reporting Standard for Small Entities (FRSSE), it may prepare its financial statements in accordance with that standard;
 - (b) If the entity is not eligible to apply the FRSSE, or if the entity is eligible to apply the FRSSE but chooses not to do so, the entity must apply [draft] FRS 102, EU-adopted IFRS

or, for financial statements that are the individual accounts of a qualifying entity, [draft] FRS 101.

- 7 [Draft] FRS 101 sets out a reduced disclosure framework which addresses the financial reporting requirements and disclosure exemptions for the financial statements of subsidiaries (and ultimate parents) that otherwise apply the recognition, measurement and disclosure requirements of EU-adopted IFRS.
- 8 The FRSSE sets out the financial reporting requirements for smaller entities as defined by the Companies Act 2006 or entities which are not companies but would otherwise meet the criteria of a small company.

The Financial Reporting Standard applicable in the UK and Republic of Ireland and the IFRS for SMEs

- 9 This [draft] FRS is a single financial reporting standard that aims to provide entities with succinct financial reporting requirements. The requirements in this [draft] FRS are based on the International Accounting Standards Board's (IASB) International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs). The IFRS for SMEs is intended to apply to the general purpose financial statements of, and other financial reporting by, entities that in many countries are referred to by a variety of terms including 'small and medium-sized', 'private' and 'non-publicly accountable'.
- 10 The ASB first consulted on the application of the IFRS for SMEs to replace extant Financial Reporting Standards in the United Kingdom and Republic of Ireland in 2006. In 2010 the ASB issued a financial reporting exposure draft (FRED) proposing the application of the IFRS for SMEs to entities that did not have public accountability and were not eligible to apply the FRSSE. Entities with public accountability would have been required to apply EU-adopted IFRS; respondents to the proposals were not supportive of the extension of EU-adopted IFRS. Based on this feedback, the ASB decided to amend the IFRS for SMEs so that it is relevant to a broader group of preparers and users.
- 11 The IFRS for SMEs is a simplification of principles in International Financial Reporting Standards (IFRS) for recognising and measuring assets, liabilities, income and expenses; in most cases it includes only the simpler accounting treatment where IFRS permit accounting options, it contains fewer disclosures and it is drafted in a simpler form than IFRS. Whilst respondents to the 2010 FRED welcomed simplification, many did not support the removal of accounting options where those options were permitted in extant FRS. As a consequence, the ASB amended the IFRS for SMEs to include accounting options permitted by IFRS but not included in the IFRS for SMEs.
- 12 The ASB also issued a FRED in 2011 that proposed accounting requirements addressing the accounting for some transactions and circumstances that are common to public benefit entities. Respondents to that FRED noted that it was difficult to identify when the requirements in the FRED should be applied. The ASB consequently decided to combine the requirements of the two FREDs into one FRS.
- 13 The ASB has thus modified the IFRS for SMEs substantially, both in terms of the scope of entities eligible to apply it and in terms of the accounting treatments provided. The ASB revised the name of the standard to [draft] FRS 102 'Financial Reporting Standard applicable in the UK and Republic of Ireland'.
- 14 [draft] FRS 102 is designed to apply to the general purpose financial statements and financial reporting of all entities and not just profit-oriented entities. General purpose financial statements are directed towards the common information needs of a wide range of users; shareholders, creditors, employees and the public at large, for example.

Organisation of [draft] FRS 102

- 15 [draft] FRS 102 is organised by topic with each topic presented in a separate numbered section. Cross-references to paragraphs are identified by section followed by paragraph number. Paragraph numbers are in the form of xx.yy, where xx is the section number and yy is the sequential paragraph number within that section. Those paragraphs that apply solely to public benefit entities are identified by the prefix 'PBE'. In examples that include monetary amounts, the measuring unit is Currency Unit (abbreviated as CU).
- 16 All the paragraphs of [draft] FRS 102 have equal authority. Some sections include appendices of implementation guidance that are not part of the [draft] FRS but which provide guidance concerning its application.

SECTION 1

Scope

- 1.1 This [draft] FRS applies to **financial statements** that are intended to give a true and fair view of a reporting entity's **financial position** and **profit or loss** (or **income** and expenditure) for a period.
- 1.2 In accordance with [draft] FRS 100 '**Application of Financial Reporting Requirements**', an entity that is required by the **IAS Regulation** (or other legislation or regulation) to prepare **consolidated financial statements** in accordance with **EU-adopted IFRS** must do so. The **individual accounts** of such an entity, or the individual accounts or consolidated financial statements of any other entity within the scope of [draft] FRS 100, must be prepared in accordance with the following requirements:
 - (a) If the entity is eligible to apply the '**Financial Reporting Standard for Smaller Entities**' (FRSSE), it may prepare its financial statements in accordance with that standard;
 - (b) If the entity is not eligible to apply the FRSSE, or if the entity is eligible to apply the FRSSE but chooses not to do so, the entity must apply this [draft] FRS, EU-adopted IFRS or, for financial statements that are the individual accounts of a qualifying entity (as defined in the glossary included as Appendix I to [draft] FRS 100), [draft] FRS 101 '**Reduced Disclosure Framework**'*.
- 1.3 An entity whose **ordinary shares** or **potential ordinary shares** are publicly traded, or that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing ordinary shares in a public market, or an entity that chooses to disclose earnings per share, shall apply IAS 33 *Earnings per Share* (as adopted in the EU).
- 1.4 An entity whose ordinary shares or potential ordinary shares are **publicly traded**, or that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing ordinary shares in a public market, or an entity that chooses to prepare an interim financial report described as complying with IAS 34 *Interim Financial Reporting*, shall apply that standard (as adopted in the EU).
- 1.5 An entity whose debt or **equity** instruments are publicly traded, or that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market, or an entity that chooses to provide information described as segmental information, shall apply IFRS 8 *Operating Segments* (as adopted in the EU).
- 1.6 An entity shall apply IFRS 4 *Insurance Contracts* (as adopted in the EU) to:
 - (a) **insurance contracts** (including **reinsurance contracts**) that it issues and reinsurance contracts that it holds.
 - (b) financial instruments issued by an entity with a **discretionary participation feature**.
- 1.7 References in IAS 33, IAS 34 and IFRS 8 are amended to refer to the relevant paragraph in this [draft] FRS.

* Individual accounts that are prepared by a company in accordance with [draft] FRS 101 or [draft] FRS 102 are Companies Act individual accounts (section 395(1)(a) of the Act), whereas individual accounts that are prepared by a company in accordance with EU-adopted IFRS are IAS individual accounts (section 395(1)(b) of the Act).

Reduced disclosures for subsidiaries (and ultimate parents)

- 1.8 A **qualifying entity** apply this [draft] FRS which is not a **financial institution** may take advantage in its individual accounts of the disclosure exemptions set out in paragraphs 1.12–1.13 of this [draft] FRS. Where a qualifying entity has financial liabilities held at fair value which are neither held as part of a trading portfolio nor are derivatives, must also apply the disclosure requirements of paragraph 11.48A*.
- 1.9 A qualifying entity which is a financial institution may take advantage in its individual accounts of the disclosure exemptions set out in paragraphs 1.12–1.13 of this [draft] FRS, other than the disclosure exemptions from Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instrument Issues*.
- 1.10 A qualifying entity which is required to prepare consolidated accounts (for example, if the entity is required by section 399 of the Act to prepare consolidated accounts, and is not entitled to any of the exemptions in sections 400–402 of the Act), or which voluntarily chooses to do so, may not take advantage of the disclosure exemptions set out in paragraphs 1.12–1.13 of this [draft] FRS in its consolidated accounts.
- 1.11 A qualifying entity may take advantage of the disclosure exemptions in paragraph 1.12–1.13 of this [draft] FRS, in accordance with paragraphs 1.8–1.10 of this [draft] FRS, only if:
- (a) its shareholders have been notified in writing about, and do not object to, the use of the disclosure exemptions. A shareholder may object to the use of the disclosure exemptions only if the shareholder is the immediate parent of the entity, or if the shareholder holds more than half of the allotted shares in the entity that are not held by the immediate parent, or if the shareholder holds 5% or more of the total allotted shares in the entity;
 - (b) it otherwise applies the recognition, measurement and disclosure requirements of this [draft] FRS; and
 - (c) it states in the notes to its financial statements:
 - (i) the relevant section and paragraph references of the exemptions adopted; and
 - (ii) the name of the parent in whose consolidated financial statements its financial statements are consolidated, and from where those financial statements may be obtained.
- 1.12 A qualifying entity may take advantage of the following disclosure exemptions:
- (a) the requirements of Section 7 *Statement of Cash Flows* and Section 3 *Financial Statement Presentation* paragraph 3.17(d);
 - (b) the requirements of Section 11 *Basic Financial Instruments* paragraphs 11.39–11.48 and Section 12 *Other Financial Instrument Issues* paragraphs 12.26–12.29 providing the equivalent disclosures required by this [draft] FRS are included in the consolidated financial statements of the group in which the entity is consolidated;
 - (c) the requirement of Section 17 *Property, Plant and Equipment* paragraph 17.32(b);
 - (d) the requirement of Section 18 *Intangible Assets other than Goodwill* paragraph 18.28(d);

* Paragraph 36(4) of Schedule 1 to the Regulations.

- (e) the requirements of Section 26 *Share-based Payment* paragraphs 26.18(b), 26.19-26.21 and 26.23, except for a **group** arrangement involving equity instruments of an entity other than the parent, providing the equivalent disclosures required by this [draft] FRS are included in the consolidated financial statements of the group in which the entity is consolidated; and
 - (f) the requirement of Section 33 *Related Party Disclosures* paragraph 33.7.
- 1.13 Reference should be made to the Application Guidance to [draft] FRS 100 in deciding whether the consolidated financial statements of the parent provide disclosures which are equivalent to the requirements of this [draft] FRS (the full requirements of this [draft] FRS, when not applying the reduced disclosure framework), from which relief is provided in paragraph 1.12 of this [draft] FRS.

Date from which effective and transitional arrangements

- 1.14 An entity shall apply this [draft] FRS for accounting periods beginning on or after [1 January 2015]. Early application is permitted for accounting periods beginning on or after the date of issue of this standard, subject to the additional requirement for a public benefit entity that it must also apply a public benefit entity SORP which has been developed in accordance with this [draft] FRS, [draft] FRS 100 and [draft] FRS 101.

SECTION 2

CONCEPTS AND PERVASIVE PRINCIPLES

Scope of this section

- 2.1 This section describes the **objective of financial statements** of entities within the scope of this [draft] FRS and the qualities that make the information in the financial statements of entities within the scope of this [draft] FRS useful. It also sets out the concepts and basic principles underlying the financial statements of entities within the scope of this [draft] FRS.

Objective of financial statements

- 2.2 The objective of financial statements is to provide information about the **financial position, performance** and **cash flows** of the entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs.
- 2.3 Financial statements also show the results of the stewardship of management—the accountability of management for the resources entrusted to it.

Qualitative characteristics of information in financial statements

Understandability

- 2.4 The information provided in financial statements should be presented in a way that makes it comprehensible by users who have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, the need for understandability does not allow relevant information to be omitted on the grounds that it may be too difficult for some users to understand.

Relevance

- 2.5 The information provided in financial statements must be relevant to the decision-making needs of users. Information has the quality of **relevance** when it is capable of influencing the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.

Materiality

- 2.6 Information is **material**—and therefore has relevance—if its omission or misstatement could influence the economic decisions of users made on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. However, it is inappropriate to make, or leave uncorrected, immaterial departures from this [draft] FRS to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

Reliability

- 2.7 The information provided in financial statements must be **reliable**. Information is reliable when it is free from material error and bias and represents faithfully that which it either purports to represent or could reasonably be expected to represent. Financial statements are not free from bias (ie not neutral) if, by the selection or presentation of information, they are intended to influence the making of a decision or judgement in order to achieve a predetermined result or outcome.

Substance over form

- 2.8 Transactions and other events and conditions should be accounted for and presented in accordance with their substance and not merely their legal form. This enhances the reliability of financial statements.

Prudence

- 2.9 The uncertainties that inevitably surround many events and circumstances are acknowledged by the disclosure of their nature and extent and by the exercise of **prudence** in the preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses. In short, prudence does not permit bias.

Completeness

- 2.10 To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

Comparability

- 2.11 Users must be able to compare the financial statements of an entity through time to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different entities to evaluate their relative financial position, performance and cash flows. Hence, the measurement and display of the financial effects of like transactions and other events and conditions must be carried out in a consistent way throughout an entity and over time for that entity, and in a consistent way across entities. In addition, users must be informed of the **accounting policies** employed in the preparation of the financial statements, and of any changes in those policies and the effects of such changes.

Timeliness

- 2.12 To be relevant, financial information must be able to influence the economic decisions of users. **Timeliness** involves providing the information within the decision time frame. If there is undue delay in the reporting of information it may lose its relevance. Management may need to balance the relative merits of timely reporting and the provision of reliable information. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the needs of users in making economic decisions.

Balance between benefit and cost

- 2.13 The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is substantially a judgemental process. Furthermore, the costs are not necessarily borne by those users who enjoy the benefits, and often the benefits of the information are enjoyed by a broad range of external users.
- 2.14 Financial reporting information helps capital providers make better decisions, which results in more efficient functioning of capital markets and a lower cost of capital for the economy as a whole. Individual entities also enjoy benefits, including improved access to capital markets, favourable effect on public relations, and perhaps lower costs of capital. The benefits may also include better management decisions because financial information used internally is often based at least partly on information prepared for general purpose financial reporting purposes.

Financial position

- 2.15 The financial position of an entity is the relationship of its assets, liabilities and equity as of a specific date as presented in the **statement of financial position**. These are defined as follows:
- (a) An **asset** is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
 - (b) A **liability** is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
 - (c) **Equity** is the residual interest in the assets of the entity after deducting all its liabilities.
- 2.16 Some items that meet the definition of an asset or a liability may not be recognised as assets or liabilities in the statement of financial position because they do not satisfy the criteria for **recognition** in paragraphs 2.27–2.32. In particular, the expectation that future economic benefits will flow to or from an entity must be sufficiently certain to meet the probability criterion before an asset or liability is recognised.

Assets

- 2.17 The future economic benefit of an asset is its potential to contribute, directly or indirectly, to the flow of cash and **cash equivalents** to the entity. Those cash flows may come from using the asset or from disposing of it.
- 2.18 Many assets, for example property, plant and equipment, have a physical form. However, physical form is not essential to the existence of an asset. Some assets are intangible.
- 2.19 In determining the existence of an asset, the right of ownership is not essential. Thus, for example, property held on a lease is an asset if the entity controls the benefits that are expected to flow from the property.

Liabilities

- 2.20 An essential characteristic of a liability is that the entity has a present obligation to act or perform in a particular way. The obligation may be either a legal obligation or a **constructive obligation**. A legal obligation is legally enforceable as a consequence of a binding contract or statutory requirement. A constructive obligation is an obligation that derives from an entity's actions when:
- (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept particular responsibilities, and
 - (b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.
- 2.21 The settlement of a present obligation usually involves the payment of cash, transfer of other assets, provision of services, the replacement of that obligation with another obligation, or conversion of the obligation to equity. An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights.

Equity

- 2.22 Equity is the residual of recognised assets minus recognised liabilities. It may be subclassified in the statement of financial position. For example, in a corporate entity, subclassifications may

include funds contributed by shareholders, retained earnings and gains or losses recognised directly in equity.

Performance

- 2.23 Performance is the relationship of the income and expenses of an entity during a **reporting period**. This [draft] FRS permits entities to present performance in a single financial statement (a **statement of comprehensive income**) or in two financial statements (an **income statement** and a statement of comprehensive income). **Total comprehensive income** and **profit or loss** are frequently used as measures of performance or as the basis for other measures, such as return on investment or earnings per share. Income and expenses are defined as follows:
- (a) **Income** is increases in economic benefits during the reporting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity investors.
 - (b) **Expenses** are decreases in economic benefits during the reporting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity investors.
- 2.24 The recognition of income and expenses results directly from the recognition and measurement of assets and liabilities. Criteria for the recognition of income and expenses are discussed in paragraphs 2.27–2.32.

Income

- 2.25 The definition of income encompasses both revenue and gains.
- (a) **Revenue** is income that arises in the course of the ordinary activities of an entity and is referred to by a variety of names including sales, fees, interest, dividends, royalties and rent.
 - (b) **Gains** are other items that meet the definition of income but are not revenue. When gains are recognised in the statement of comprehensive income, they are usually displayed separately because knowledge of them is useful for making economic decisions.

Expenses

- 2.26 The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity.
- (a) **Expenses** that arise in the course of the ordinary activities of the entity include, for example, cost of sales, wages and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory, or property, plant and equipment.
 - (b) **Losses** are other items that meet the definition of expenses and may arise in the course of the ordinary activities of the entity. When losses are recognised in the statement of comprehensive income, they are usually presented separately because knowledge of them is useful for making economic decisions.

Recognition of assets, liabilities, income and expenses

- 2.27 Recognition is the process of incorporating in the financial statements an item that meets the definition of an asset, liability, income or expense and satisfies the following criteria:
- (a) it is **probable** that any future economic benefit associated with the item will flow to or from the entity, and

(b) the item has a cost or value that can be measured reliably.

- 2.28 The failure to recognise an item that satisfies those criteria is not rectified by disclosure of the accounting policies used or by **notes** or explanatory material.

The probability of future economic benefit

- 2.29 The concept of probability is used in the first recognition criterion to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the entity. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence relating to conditions at the end of the reporting period available when the financial statements are prepared. Those assessments are made individually for individually significant items, and for a group for a large population of individually insignificant items.

Reliability of measurement

- 2.30 The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability. In many cases, the cost or value of an item is known. In other cases it must be estimated. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When a reasonable estimate cannot be made, the item is not recognised in the financial statements.
- 2.31 An item that fails to meet the recognition criteria may qualify for recognition at a later date as a result of subsequent circumstances or events.
- 2.32 An item that fails to meet the criteria for recognition may nonetheless warrant disclosure in the notes or explanatory material or in supplementary schedules. This is appropriate when knowledge of the item is relevant to the evaluation of the financial position, performance and changes in financial position of an entity by the users of financial statements.

Measurement of assets, liabilities, income and expenses

- 2.33 **Measurement** is the process of determining the monetary amounts at which an entity measures assets, liabilities, income and expenses in its financial statements. Measurement involves the selection of a basis of measurement. This [draft] FRS specifies which measurement basis an entity shall use for many types of assets, liabilities, income and expenses.
- 2.34 Two common measurement bases are historical cost and fair value:
- (a) For assets, **historical cost** is the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire the asset at the time of its acquisition. For liabilities, historical cost is the amount of proceeds of cash or cash equivalents received or the fair value of non-cash assets received in exchange for the obligation at the time the obligation is incurred, or in some circumstances (for example, income tax) the amounts of cash or cash equivalents expected to be paid to settle the liability in the normal course of business. Amortised historical cost is the historical cost of an asset or liability plus or minus that portion of its historical cost previously recognised as expense or income.
 - (b) **Fair value** is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Pervasive recognition and measurement principles

- 2.35 The requirements for recognising and measuring assets, liabilities, income and expenses in this [draft] FRS are based on pervasive principles that are derived from the IASB *Framework for the Preparation and Presentation of Financial Statements* and from **EU-adopted IFRS**. In the absence

of a requirement in this [draft] FRS that applies specifically to a transaction or other event or condition, paragraph 10.4 provides guidance for making a judgement and paragraph 10.5 establishes a hierarchy for an entity to follow in deciding on the appropriate accounting policy in the circumstances. The second level of that hierarchy requires an entity to look to the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles set out in this section.

Accrual basis

- 2.36 An entity shall prepare its financial statements, except for cash flow information, using the **accrual basis** of accounting. On the accrual basis, items are recognised as assets, liabilities, equity, income or expenses when they satisfy the definitions and recognition criteria for those items.

Recognition in financial statements

Assets

- 2.37 An entity shall recognise an asset in the statement of financial position when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably. An asset is not recognised in the statement of financial position when expenditure has been incurred for which it is considered not probable that economic benefits will flow to the entity beyond the current reporting period. Instead such a transaction results in the recognition of an expense in the statement of comprehensive income (or in the income statement, if presented).
- 2.38 An entity shall not recognise a **contingent asset** as an asset. However, when the flow of future economic benefits to the entity is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate.

Liabilities

- 2.39 An entity shall recognise a liability in the statement of financial position when
- (a) the entity has an obligation at the end of the reporting period as a result of a past event,
 - (b) it is probable that the entity will be required to transfer resources embodying economic benefits in settlement, and
 - (c) the settlement amount can be measured reliably.
- 2.40 A **contingent liability** is either a possible but uncertain obligation or a present obligation that is not recognised because it fails to meet one or both of the conditions (b) and (c) in paragraph 2.39. An entity shall not recognise a contingent liability as a liability, except for contingent liabilities of an acquirer in a business combination (see Section 19 *Business Combinations and Goodwill*).

Income

- 2.41 The recognition of income results directly from the recognition and measurement of assets and liabilities. An entity shall recognise income in the statement of comprehensive income (or in the income statement, if presented) when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably.

Expenses

- 2.42 The recognition of expenses results directly from the recognition and measurement of assets and liabilities. An entity shall recognise expenses in the statement of comprehensive income (or in the income statement, if presented) when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

Total comprehensive income and profit or loss

- 2.43 Total comprehensive income is the arithmetical difference between income and expenses. It is not a separate element of financial statements, and a separate recognition principle is not needed for it.
- 2.44 Profit or loss is the arithmetical difference between income and expenses other than those items of income and expense that this [draft] FRS classifies as items of other comprehensive income. It is not a separate element of financial statements, and a separate recognition principle is not needed for it.
- 2.45 This [draft] FRS does not allow the recognition of items in the statement of financial position that do not meet the definition of assets or of liabilities regardless of whether they result from applying the notion commonly referred to as the ‘matching concept’ for measuring profit or loss.

Measurement at initial recognition

- 2.46 At initial recognition, an entity shall measure assets and liabilities at historical cost unless this [draft] FRS requires initial measurement on another basis such as fair value.

Subsequent measurement

Financial assets and financial liabilities

- 2.47 An entity measures basic **financial assets** and basic **financial liabilities**, as defined in Section 11 *Basic Financial Instruments*, at amortised cost less impairment except for investments in non-convertible and non-puttable preference shares and non-puttable ordinary shares that are **publicly traded** or whose fair value can otherwise be measured reliably, which are measured at fair value with changes in fair value recognised in profit or loss.
- 2.48 An entity generally measures all other financial assets and financial liabilities at fair value, with changes in fair value recognised in profit or loss, unless this [draft] FRS requires or permits measurement on another basis such as cost or amortised cost.

Non-financial assets

- 2.49 Most non-financial assets that an entity initially recognised at historical cost are subsequently measured on other measurement bases. For example:
- (a) An entity measures property, plant and equipment using either the cost model or the revaluation model.
 - (b) An entity measures inventories at the lower of cost and selling price less costs to complete and sell.
 - (c) An entity recognises an impairment loss relating to non-financial assets that are in use or held for sale.

Measurement of assets at those lower amounts is intended to ensure that an asset is not measured at an amount greater than the entity expects to recover from the sale or use of that asset.

- 2.50 For certain types of non-financial assets, this [draft] FRS permits or requires measurement at fair value. For example:

- (a) [not used]
- (b) **investment property** that an entity measures at fair value (see paragraph 16.7).
- (c) agricultural assets (**biological assets** and **agricultural produce** at the point of harvest) that an entity measures at fair value less estimated costs to sell (see paragraph 34.2).

Liabilities other than financial liabilities

- 2.51 Most liabilities other than financial liabilities are measured at the best estimate of the amount that would be required to settle the obligation at the **reporting date**.

Offsetting

- 2.52 An entity shall not offset assets and liabilities, or income and expenses, unless required or permitted by this [draft] FRS.

- (a) Measuring assets net of valuation allowances – for example, allowances for inventory obsolescence and allowances for uncollectible receivables – is not offsetting.
- (b) If an entity's normal operating activities do not include buying and selling fixed assets, including investments and operating assets, then the entity reports gains and losses on disposal of such assets by deducting from the proceeds on disposal the **carrying amount** of the asset and related selling expenses.

Intermediate payment arrangements

- 2.53 An 'intermediate payment arrangement' includes arrangements where an entity makes payments to a trust, and the trust uses the payments to accumulate assets to pay the entity's employees for services the employees have rendered to the entity. Such arrangements may take a variety of forms:

- (a) Although the intermediary is usually constituted as a trust, other arrangements are possible.
- (b) Although such arrangements are most commonly used to pay employees, they are sometimes used to compensate suppliers of goods and services other than employee services. Sometimes the entity's employees and other suppliers are not the only beneficiaries of the arrangement. Other beneficiaries may include past employees and their dependants, and the intermediary may be entitled to make charitable donations.
- (c) Usually, the precise identity of the persons or entities that will receive payments from the intermediary, and the amounts that they will receive, are not agreed at the outset.
- (d) The relationship between the entity and the intermediary may take different forms. For example, when the intermediary is constituted as a trust, the entity will not have a right to direct the intermediary's activities. However, in these and other cases the entity may give advice to the intermediary or may be relied on by the intermediary to provide the information it needs to carry out its activities. Sometimes, the way the intermediary has been set up gives it little discretion in the broad nature of its activities.

- (e) Often, the entity has the right to appoint or veto the appointment of the intermediary's trustees (or its directors or the equivalent).
 - (f) The payments made to the intermediary and the payments made by the intermediary are often cash payments but may involve other transfers of value.
- 2.54 When an entity makes payments (or transfers assets) to an intermediary, there is a rebuttable presumption that the entity has exchanged one asset for another and that the payment itself does not represent an immediate expense. To rebut this presumption at the time the payment is made to the intermediary, the entity must demonstrate:
- (a) It will not obtain future economic benefit from the amounts transferred; or
 - (b) It does not have control of the right or other access to the future economic benefit it is expected to receive.
- 2.55 Where a payment to an intermediary is an exchange by the entity of one asset for another, any assets that the intermediary acquires in a subsequent exchange transaction will also be under the control of the entity. An asset will cease to be recognised as an asset of the entity when, for example, the asset of the intermediary vests unconditionally in identified beneficiaries.
- 2.56 When an entity recognises the assets and liabilities held by an intermediary, it should disclose sufficient information in the notes to its financial statements to enable readers to understand any restrictions relating to those assets and liabilities.

SECTION 3

FINANCIAL STATEMENT PRESENTATION

Scope of this section

- 3.1 This section explains **fair presentation** of **financial statements**, what compliance with this [draft] FRS requires, and what is a complete set of financial statements.

Fair presentation

- 3.2 Financial statements shall present fairly the **financial position**, financial **performance** and **cash flows** of an 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, income and expenses set out in Section 2 *Concepts and Pervasive Principles*.

- (a) The application of this [draft] FRS, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation of the financial position, financial performance and cash flows of entities within the scope of this [draft] FRS.
- (b) [Not used]

The additional disclosures referred to in (a) are necessary when compliance with the specific requirements in this [draft] FRS is insufficient to enable users to understand the effect of particular transactions, other events and conditions on the entity's financial position and financial performance.

Compliance with this [draft] FRS

- 3.3 An entity whose financial statements comply with this [draft] FRS shall make an explicit and unreserved statement of such compliance in the **notes**. Financial statements shall not be described as complying with this [draft] FRS unless they comply with all the requirements of this [draft] FRS.
- 3.4 In the extremely rare circumstances when management concludes that compliance with this [draft] FRS would be so misleading that it would conflict with the **objective of financial statements** of entities within the scope of this [draft] FRS set out in Section 2, the entity shall depart from that requirement in the manner set out in paragraph 3.5.
- 3.5 When an entity departs from a requirement of this [draft] FRS in accordance with paragraph 3.4, or from a requirement of applicable legislation, it shall disclose the following:
- (a) that management has concluded that the financial statements present fairly the entity's financial position, financial performance and cash flows.
 - (b) that it has complied with this [draft] FRS, except that it has departed from a particular requirement of this [draft] FRS or companies legislation to achieve a fair presentation.
 - (c) the nature of the departure, including the treatment that this [draft] FRS or companies legislation would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in Section 2, and the treatment adopted.

- 3.6 When an entity has departed from a requirement of this [draft] FRS or companies legislation in a prior period, and that departure affects the amounts recognised in the financial statements for the current period, it shall make the disclosures set out in paragraph 3.5(c).
- 3.7 [Not used]

Going concern

- 3.8 When preparing financial statements, the management of an entity using this [draft] FRS shall make an assessment of the entity's ability to continue as a going concern. An entity is a going concern unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the **reporting date**.
- 3.9 When management is aware, in making its assessment, of **material** uncertainties related to events or conditions that cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

Frequency of reporting

- 3.10 An entity shall present a complete set of financial statements (including comparative information – see paragraph 3.14) at least annually. When the end of an entity's **reporting period** changes and the annual financial statements are presented for a period longer or shorter than one year, the entity shall disclose the following:
- (a) that fact.
 - (b) the reason for using a longer or shorter period.
 - (c) the fact that comparative amounts presented in the financial statements (including the related notes) are not entirely comparable.

Consistency of presentation

- 3.11 An entity shall retain the presentation and classification of items in the financial statements from one period to the next unless:
- (a) it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of **accounting policies** in Section 10 *Accounting Policies, Estimates and Errors*, or
 - (b) this [draft] FRS requires a change in presentation.
- 3.12 When the presentation or classification of items in the financial statements is changed, an entity shall reclassify comparative amounts unless the reclassification is **impracticable**. When comparative amounts are reclassified, an entity shall disclose the following:
- (a) the nature of the reclassification.
 - (b) the amount of each item or class of items that is reclassified.
 - (c) the reason for the reclassification.

- 3.13 If it is impracticable to reclassify comparative amounts, an entity shall disclose why reclassification was not practicable.

Comparative information

- 3.14 Except when this [draft] FRS permits or requires otherwise, an entity shall disclose comparative information in respect of the previous comparable period for all amounts presented in the current period's financial statements. An entity shall include comparative information for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.

Materiality and aggregation

- 3.15 An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial.
- 3.16 Financial statements result from processing large numbers of transactions or other events that are aggregated into classes according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data, which form line items in the financial statements. If a line item is not individually material, it is aggregated with other items either in those statements or in the notes. An item that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes.
- 3.16A An entity need not provide a specific disclosure required by this [draft] FRS if the information is not material.

Complete set of financial statements

- 3.17 A complete set of financial statements of an entity shall include all of the following:
- (a) a **statement of financial position** as at the **reporting date**.
 - (b) either:
 - (i) a single **statement of comprehensive income** for the reporting period displaying all items of income and expense recognised during the period including those items recognised in determining **profit or loss** (which is a subtotal in the statement of comprehensive income) and items of **other comprehensive income**, or
 - (ii) a separate **income statement** and a separate statement of comprehensive income. If an entity chooses to present both an income statement and a statement of comprehensive income, the statement of comprehensive income begins with profit or loss and then displays the items of other comprehensive income.
 - (c) a **statement of changes in equity** for the reporting period.
 - (d) a **statement of cash flows** for the reporting period.
 - (e) **notes**, comprising a summary of significant accounting policies and other explanatory information.
- 3.18 If the only changes to equity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period **errors**, and changes in accounting policy, the entity may present a single **statement of income and retained**

earnings in place of the statement of comprehensive income and statement of changes in equity (see paragraph 6.4).

- 3.19 If an entity has no items of other comprehensive income in any of the periods for which financial statements are presented, it may present only an income statement, or it may present a statement of comprehensive income in which the 'bottom line' is labelled 'profit or loss'.
- 3.20 Because paragraph 3.14 requires comparative amounts in respect of the previous period for all amounts presented in the financial statements, a complete set of financial statements means that an entity shall present, as a minimum, two of each of the required financial statements and related notes.
- 3.21 In a complete set of financial statements, an entity shall present each financial statement with equal prominence.
- 3.22 An entity may use titles for the financial statements other than those used in this [draft] FRS as long as they are not misleading.

Identification of the financial statements

- 3.23 An entity shall clearly identify each of the financial statements and the notes and distinguish them from other information in the same document. In addition, an entity shall display the following information prominently, and repeat it when necessary for an understanding of the information presented:
 - (a) the name of the reporting entity and any change in its name since the end of the preceding reporting period.
 - (b) whether the financial statements cover the individual entity or a **group** of entities.
 - (c) the date of the end of the reporting period and the period covered by the financial statements.
 - (d) the **presentation currency**, as defined in Section 30 *Foreign Currency Translation*.
 - (e) the level of rounding, if any, used in presenting amounts in the financial statements.
- 3.24 An entity shall disclose the following in the notes:
 - (a) the domicile and legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different from the registered office).
 - (b) a description of the nature of the entity's operations and its principal activities.

Presentation of information not required by this [draft] FRS

- 3.25 This [draft] FRS does not address presentation of segment information, earnings per share, or interim financial reports. As set out in paragraphs 1.3 to 1.5, an entity applying this [draft] FRS and making such disclosures shall apply the relevant EU-adopted IFRS.

SECTION 4

STATEMENT OF FINANCIAL POSITION

Scope of this section

- 4.1 This section sets out the information that is to be presented in a **statement of financial position** and how to present it. The statement of financial position (which can also be called the balance sheet) presents an entity's **assets, liabilities** and **equity** as of a specific date—the end of the **reporting period**. This section applies to all entities, whether or not they report under the Act. Entities that do not report under the **Act** should comply with the requirements of this section, and with the **Regulations** where referred to in this section, except to the extent that these requirements are not permitted by any statutory framework under which such entities report.

Information to be presented in the statement of financial position

- 4.2 An entity other than a banking entity or an insurance entity shall present a balance sheet in accordance with Schedule 1 to the Regulations. An entity that is:
- (a) a banking entity^{*} shall prepare a balance sheet in accordance with Schedule 2 to the Regulations.
 - (b) an insurance entity[†] shall prepare a balance sheet in accordance with Schedule 3 to the Regulations.
- Group accounts shall be presented in accordance with Schedule 6 to the Regulations.
- 4.3 An entity shall present additional line items, headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position.

4.4 - 4.6 [Not used]

Creditors: amounts falling due within one year

- 4.7 An entity shall classify a liability as due within one year when the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after reporting date.
- 4.8 [Not used]

^{*} A banking entity is an entity that meets the company law definition of a banking company in Section 1164 of the Act; including entities that are not companies but otherwise meet the definition.

[†] An insurance entity is an entity that meets the company law definition of an insurance company in Section 1165 of the Act; including entities that are not companies but otherwise meet the definition.

Information to be presented either in the statement of financial position or in the notes

4.9 - 4.11 [Not used]

4.12 An entity with share capital shall disclose the following, either in the statement of financial position or in the notes:

- (a) for each class of share capital:
 - (i) [Not used]
 - (ii) the number of shares issued and fully paid, and issued but not fully paid.
 - (iii) par value per share, or that the shares have no par value.
 - (iv) a reconciliation of the number of shares outstanding at the beginning and at the end of the period.
 - (v) the rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital.
 - (vi) shares in the entity held by the entity or by its subsidiaries, associates, or joint ventures.
 - (vii) shares reserved for issue under options and contracts for the sale of shares, including the terms and amounts.
- (b) a description of each reserve within equity.

4.13 An entity without share capital, such as a partnership or trust, shall disclose information equivalent to that required by paragraph 4.12(a), showing changes during the period in each category of equity, and the rights, preferences and restrictions attaching to each category of equity.

Information to be presented in the notes

4.14 If, at the reporting date, an entity has a binding sale agreement for a major disposal of assets, or a **disposal group**, the entity shall disclose the following information:

- (a) a description of the asset(s) or the disposal group.
- (b) a description of the facts and circumstances of the sale or plan.
- (c) the carrying amount of the assets or, for a disposal group, the carrying amounts of the underlying assets and liabilities.

SECTION 5

STATEMENT OF COMPREHENSIVE INCOME AND INCOME STATEMENT

Scope of this section

- 5.1 This section requires an entity to present its **total comprehensive income** for a period—ie its financial performance for the period—in one or two **financial statements**. It sets out the information that is to be presented in those statements and how to present it. This section applies to all entities, whether or not they report under the **Act**. Entities that do not report under the Act should comply with the requirements of this section, and with the **Regulations** where referred to in this section, except to the extent that these requirements are not permitted by any statutory framework under which such entities report.

Presentation of total comprehensive income

- 5.2 An entity shall present its total comprehensive income for a period either:
- (a) in a single **statement of comprehensive income**, in which case the statement of comprehensive income presents all items of income and expense recognised in the period, or
 - (b) in two statements—an **income statement** (which is the profit and loss account required by the Regulations plus any additional requirements of this Section) and a statement of comprehensive income—in which case the income statement presents all items of income and expense recognised in the period except those that are recognised in total comprehensive income outside of **profit or loss** as permitted or required by this [draft] FRS.
- 5.3 A change from the single-statement approach to the two-statement approach, or vice versa, is a change in accounting policy to which Section 10 *Accounting Policies, Estimates and Errors* applies.

Single-statement approach

- 5.4 Under the single-statement approach, the statement of comprehensive income shall include all items of income and expense recognised in a period unless this [draft] FRS requires otherwise. This [draft] FRS provides different treatment for the following circumstances:
- (a) The effects of corrections of **material** errors and changes in **accounting policies** are presented as retrospective adjustments of prior periods rather than as part of profit or loss in the period in which they arise (see Section 10).
 - (b) Five types of **other comprehensive income** are recognised as part of total comprehensive income, outside of profit or loss, when they arise:
 - (i) some **gains** and losses arising on translating the financial statements of a foreign operation (see Section 30 *Foreign Currency Translation*).
 - (ii) some actuarial gains and losses (see Section 28 *Employee Benefits*).
 - (iii) some changes in fair values of hedging instruments (see Section 12 *Other Financial Instruments Issues*).

- (iv) some changes in fair values of investments in subsidiaries, associates and joint ventures (see Section 9 *Consolidated and Separate Financial Statements*, Section 14 *Investments in Associates* and Section 15 *Investments in Joint Ventures*).
 - (v) some gains and losses arising on revaluation of property, plant and equipment, intangible assets and heritage assets (see Section 17 *Property, Plant and Equipment*, Section 18 *Intangible Assets other than Goodwill* and Section 34 *Specialised Activities*).
- 5.5 An entity other than a banking entity or an insurance entity shall present, in the statement of comprehensive income, the items to be included in a profit and loss account in accordance with Schedule 1 to the Regulations. An entity that is:
- (a) a banking entity* shall present, in the statement of comprehensive income, the items to be included a profit and loss account in accordance with Schedule 2 to the Regulations.
 - (b) an insurance entity† shall present, in the statement of comprehensive income, the items to be included in a profit and loss account in accordance with Schedule 3 to the Regulations.
- Group accounts shall be presented in accordance with Schedule 6 to the Regulations.
- 5.5A In addition an entity shall include, in the statement of comprehensive income, line items that present the following amounts for the period:
- (a) each item of other comprehensive income (see paragraph 5.4(b)) classified by nature (excluding amounts in (b)).
 - (b) share of the other comprehensive income of associates and jointly controlled entities accounted for by the equity method.
 - (c) total comprehensive income.
- 5.6 An entity shall disclose separately the following items in the statement of comprehensive income as allocations for the period:
- (a) profit or loss for the period attributable to
 - (i) **non-controlling interest**.
 - (ii) **owners** of the parent.
 - (b) total comprehensive income for the period attributable to
 - (i) non-controlling interest.
 - (ii) owners of the parent.

* A banking entity is an entity that meets the company law definition of a banking company in Section 1164 of the Act; including entities that are not companies but otherwise meet the definition.

† An insurance entity is an entity that meets the company law definition of an insurance company in Section 1165 of the Act; including entities that are not companies but otherwise meet the definition.

Two-statement approach

- 5.7 Under the two-statement approach, an entity other than a banking entity or an insurance entity shall present a profit and loss account in accordance with Schedule 1 to the Regulations. An entity that is:
- (a) a banking entity^{*} shall present a profit and loss account in accordance with Schedule 2 to the Regulations.
 - (b) an insurance entity[†] shall present a profit and loss account in accordance with Schedule 3 to the Regulations.

Group accounts shall be presented in accordance with Schedule 6 to the Regulations.

- 5.7A The statement of comprehensive income shall begin with profit or loss as its first line and shall display, as a minimum, line items that present the amounts in paragraph 5.5A and paragraph 5.6 for the period.

Requirements applicable to both approaches

- 5.7B The profit and loss account (or statement of comprehensive income) shall also present an amount comprising the total of:
- (a) the post-tax profit or loss of a **discontinued operation**; and
 - (b) the post-tax gain or loss recognised on the impairment or on the disposal of the net assets constituting a discontinued operation.

An entity shall provide an analysis between continuing operations and discontinued operations of each of the line items on the face of the statement of comprehensive income, or income statement and statement of comprehensive income, as shown in the Appendix to this Section.

- 5.7C An entity shall re-present the disclosures in paragraph 5.7B for prior periods presented in the financial statements so that the disclosures relate to all operations that have been discontinued by the end of the reporting period for the latest period presented.
- 5.8 Under this [draft] FRS, the effects of corrections of material errors and changes in accounting policies are presented as retrospective adjustments of prior periods rather than as part of profit or loss in the period in which they arise (see Section 10).
- 5.9 An entity shall present additional line items, headings and subtotals in the statement of comprehensive income (and in the profit and loss account, under the two-statement approach), when such presentation is relevant to an understanding of the entity's financial performance.
- 5.9A When items of income or expense are material, an entity shall disclose their nature and amount separately, either in the statement of comprehensive income (or in the profit and loss account, under the two-statement approach) or in the notes.
- 5.9B This [draft] FRS does not require disclosure of 'operating profit'. However, if an entity elects to disclose the results of operating activities the entity should ensure that the amount disclosed is representative of activities that would normally be regarded as 'operating'. For example, it would be inappropriate to exclude items clearly related to operations (such as inventory write-downs and restructuring and relocation expenses) because they occur irregularly or infrequently

^{*} A banking entity is an entity that meets the company law definition of a banking company in Section 1164 of the Act; including entities that are not companies but otherwise meet the definition.

[†] An insurance entity is an entity that meets the company law definition of an insurance company in Section 1165 of the Act; including entities that are not companies but otherwise meet the definition.

or are unusual in amount. Similarly, it would be inappropriate to exclude items on the grounds that they do not involve cash flows, such as depreciation and amortisation expenses.

Ordinary activities and extraordinary items

- 5.10 Ordinary activities are any activities which are undertaken by a reporting entity as part of its business and such related activities in which the reporting entity engages in furtherance of, incidental to, or arising from, these activities. Ordinary activities include any effects on the reporting entity of any event in the various environments in which it operates, including the political, regulatory, economic and geographical environments, irrespective of the frequency or unusual nature of the events.
- 5.10A Extraordinary items are material items possessing a high degree of abnormality which arise from events or transactions that fall outside the ordinary activities of the reporting entity and which are not expected to recur. They do not include the additional line items required by paragraph 5.9, nor do they include prior period items merely because they relate to a prior period.

Analysis of expenses

- 5.11 An entity shall present an analysis of expenses using a classification based on either the nature of expenses or the function of expenses within the entity, whichever provides information that is reliable and more relevant.

Analysis by nature of expense

- (a) Under this method of classification, expenses are aggregated in the statement of comprehensive income (or in the profit and loss account, under the two-statement approach) according to their nature (eg depreciation, purchases of materials, transport costs, employee benefits and advertising costs), and are not reallocated among various functions within the entity.

Analysis by function of expense

- (b) Under this method of classification, expenses are aggregated according to their function as part of cost of sales or, for example, the costs of distribution or administrative activities. At a minimum, an entity discloses its cost of sales under this method separately from other expenses.

APPENDIX TO SECTION 5

EXAMPLE SHOWING PRESENTATION OF DISCONTINUED OPERATIONS

This Appendix accompanies, but is not part of, Section 5. It provides guidance on applying the requirements of Section 5 paragraph 5.7B for presenting discontinued operations. The example illustrates the presentation of comprehensive income in two statements and the classification of expenses within profit by function. A columnar format is used in order to present a single line item as required by paragraph 5.7B, while still complying with the requirement of the Act to show totals for ordinary activities of items such as turnover, profit or loss before taxation and tax.

Income Statement (or Profit and Loss Account)

for the year ended 31 December 20X1

	Continuing operations 20X1 CU	Discontinued operations 20X1 CU	Total 20X1 CU	Continuing Operations 20X0 CU (as restated)	Discontinued operations 20X0 CU (as restated)	Total 20X0 CU (as restated)
Turnover	4,200	1,232	5,432	3,201	1,500	4,701
Cost of Sales	(2,591)	(1,104)	(3,695)	(2,281)	(1,430)	(3,711)
Gross profit	1,609	128	1,737	920	70	990
Administrative expenses	(452)	(110)	(562)	(418)	(120)	(538)
Other operating income	212	–	212	198	–	198
Profit on disposal of operations	–	301	301	–	–	–
Operating profit	1,369	319	1,688	700	(50)	650
Interest receivable and similar income	14	–	14	16	–	16
Interest payable and similar charges	(208)	–	(208)	(208)	–	(208)
Profit on ordinary activities before tax	1,175	319	1,494	508	(50)	458
Taxation	(390)	(4)	(394)	(261)	3	(258)
Profit on ordinary activities after taxation and profit for the financial year	785	315	1,100	247	(47)	200

Statement of Comprehensive Income

for the year ended 31 December 20X1

	Continuing operations 20X1	Discontinued operations 20X1	Total 20X1	Continuing operations 20X0 (as restated)	Discontinued operations 20X0 (as restated)	Total 20X0 (as restated)
	CU	CU	CU	CU	CU	CU
Profit for the financial year	785	315	1,100	247	(47)	200
Actuarial losses on defined benefit pension plans	(85)	(23)	(108)	(51)	(17)	(68)
Deferred tax movement relating to actuarial losses	22	6	28	14	4	18
Total Comprehensive Income for the year	722	298	1,020	210	(60)	150

SECTION 6

STATEMENT OF CHANGES IN EQUITY AND STATEMENT OF INCOME AND RETAINED EARNINGS

Scope of this section

- 6.1 This section sets out requirements for presenting the changes in an entity's **equity** for a period, either in a **statement of changes in equity** or in the notes or, if specified conditions are met and an entity chooses, in a **statement of income and retained earnings**.

Statement of changes in equity

Purpose

- 6.2 The statement of changes in equity presents an entity's profit or loss for a **reporting period**, **other comprehensive income** for the period, the effects of changes in **accounting policies** and corrections of material errors recognised in the period, and the amounts of investments by, and dividends and other distributions to, equity investors during the period.

Information to be presented in the statement of changes in equity

- 6.3 An entity shall present a statement of changes in equity showing in the statement:
- (a) **total comprehensive income** for the period, showing separately the total amounts attributable to **owners** of the parent and to **non-controlling interests**.
 - (b) for each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with Section 10 *Accounting Policies, Estimates and Errors*.
 - (c) for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing changes resulting from:
 - (i) profit or loss;
 - (ii) other comprehensive income; and
 - (iii) the amounts of investments by, and dividends and other distributions to, owners, showing separately issues of shares, treasury share transactions, dividends and other distributions to owners, and changes in ownership interests in subsidiaries that do not result in a loss of control.

Information to be presented in the statement of changes in equity or in the notes

- 6.3A For each component of equity, an entity shall present, either in the statement of changes in equity or in the notes, an analysis of other comprehensive income by item (see paragraph 6.3(c)(ii)).

Statement of income and retained earnings

Purpose

- 6.4 The statement of income and retained earnings presents an entity's profit or loss and changes in retained earnings for a reporting period. Paragraph 3.18 permits an entity to present a statement of income and retained earnings in place of a statement of comprehensive income and a statement of changes in equity if the only changes to its equity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period **material** errors, and changes in accounting policy.

Information to be presented in the statement of income and retained earnings

- 6.5 An entity shall present, in the statement of income and retained earnings, the following items in addition to the information required by Section 5 *Statement of Comprehensive Income and Income Statement*:
- (a) retained earnings at the beginning of the reporting period.
 - (b) dividends declared and paid or payable during the period.
 - (c) restatements of retained earnings for corrections of prior period material errors.
 - (d) restatements of retained earnings for changes in accounting policy.
 - (e) retained earnings at the end of the reporting period.

SECTION 7

STATEMENT OF CASH FLOWS

Scope of this section

- 7.1 This section sets out the information that is to be presented in a **statement of cash flows** and how to present it. The statement of cash flows provides information about the changes in **cash** and **cash equivalents** of an entity for a **reporting period**, showing separately changes from **operating activities**, **investing activities** and **financing activities**.
- 7.1A This section does not apply to:
- (a) Mutual life assurance companies.
 - (b) Pension funds.
 - (c) Open-ended investment funds that meet all the following conditions:
 - (i) substantially all of the entity's investments are highly liquid;
 - (ii) substantially all of the entity's investments are carried at market value; and
 - (iii) the entity provides a statement of changes in net assets.

Cash equivalents

- 7.2 Cash equivalents are short-term, highly liquid investments held to meet short-term cash commitments rather than for investment or other purposes. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Bank overdrafts are normally considered financing activities similar to borrowings. However, if they are repayable on demand and form an integral part of an entity's cash management, bank overdrafts are a component of cash and cash equivalents.

Information to be presented in the statement of cash flows

- 7.3 An entity shall present a statement of cash flows that presents **cash flows** for a reporting period classified by operating activities, investing activities and financing activities.

Operating activities

- 7.4 Operating activities are the principal **revenue**-producing activities of the entity. Therefore, cash flows from operating activities generally result from the transactions and other events and conditions that enter into the determination of **profit or loss**. Examples of cash flows from operating activities are:
- (a) cash receipts from the sale of goods and the rendering of services.
 - (b) cash receipts from royalties, fees, commissions and other revenue.
 - (c) cash payments to suppliers for goods and services.
 - (d) cash payments to and on behalf of employees.

- (e) cash payments or refunds of income tax, unless they can be specifically identified with financing and investing activities.
- (f) cash receipts and payments from investments, loans and other contracts held for dealing or trading purposes, which are similar to inventory acquired specifically for resale.

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

Investing activities

7.5 Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. Examples of cash flows arising from investing activities are:

- (a) cash payments to acquire property, plant and equipment (including self-constructed property, plant and equipment), intangible assets and other long-term assets.
- (b) cash receipts from sales of property, plant and equipment, intangibles and other long-term assets.
- (c) cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments classified as cash equivalents or held for dealing or trading).
- (d) cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments classified as cash equivalents or held for dealing or trading).
- (e) cash advances and loans made to other parties.
- (f) cash receipts from the repayment of advances and loans made to other parties.
- (g) cash payments for futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading, or the payments are classified as financing activities.
- (h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading, or the receipts are classified as financing activities.

When a contract is accounted for as a hedge (see Section 12 *Other Financial Instruments Issues*), an entity shall classify the cash flows of the contract in the same manner as the cash flows of the item being hedged.

Financing activities

7.6 Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of an entity. Examples of cash flows arising from financing activities are:

- (a) cash proceeds from issuing shares or other equity instruments.
- (b) cash payments to owners to acquire or redeem the entity's shares.
- (c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings.

- (d) cash repayments of amounts borrowed.
- (e) cash payments by a lessee for the reduction of the outstanding liability relating to a **finance lease**.

Reporting cash flows from operating activities

7.7 An entity shall present cash flows from operating activities using either:

- (a) the indirect method, whereby profit or loss is adjusted for the effects of non-cash transactions, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows, or
- (b) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed.

Indirect method

7.8 Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:

- (a) changes during the period in inventories and operating receivables and payables;
- (b) non-cash items such as **depreciation, provisions, deferred tax**, accrued income (expenses) not yet received (paid) in cash, unrealised foreign currency gains and losses, undistributed profits of **associates**, and **non-controlling interests**; and
- (c) all other items for which the cash effects relate to investing or financing.

Direct method

7.9 Under the direct method, net cash flow from operating activities is presented by disclosing information about major classes of gross cash receipts and gross cash payments. Such information may be obtained either:

- (a) from the accounting records of the entity; or
- (b) by adjusting sales, cost of sales and other items in the statement of comprehensive income (or the income statement, if presented) for:
 - (i) changes during the period in **inventories** and operating receivables and payables;
 - (ii) other non-cash items; and
 - (iii) other items for which the cash effects are investing or financing cash flows.

Reporting cash flows from investing and financing activities

7.10 An entity shall present separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities. The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units shall be presented separately and classified as investing activities.

Foreign currency cash flows

- 7.11 An entity shall record cash flows arising from transactions in a foreign currency in the entity's **functional currency** by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow or an exchange rate that approximates the actual rate (for example, a weighted average exchange rate for the period).
- 7.12 The entity shall translate cash flows of a foreign subsidiary at the exchange rates between the entity's functional currency and the foreign currency at the dates of the cash flows.
- 7.13 Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, to reconcile cash and cash equivalents at the beginning and the end of the period, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency must be presented in the statement of cash flows. Therefore, the entity shall remeasure cash and cash equivalents held during the reporting period (such as amounts of foreign currency held and foreign currency bank accounts) at period-end exchange rates. The entity shall present the resulting unrealised gain or loss separately from cash flows from operating, investing and financing activities.

Interest and dividends

- 7.14 An entity shall present separately cash flows from interest and dividends received and paid. The entity shall classify cash flows consistently from period to period as operating, investing or financing activities.
- 7.15 An entity may classify interest paid and interest and dividends received as operating cash flows because they are included in profit or loss. Alternatively, the entity may classify interest paid and interest and dividends received as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.
- 7.16 An entity may classify dividends paid as a financing cash flow because they are a cost of obtaining financial resources. Alternatively, the entity may classify dividends paid as a component of cash flows from operating activities because they are paid out of operating cash flows.

Income tax

- 7.17 An entity shall present separately cash flows arising from income tax and shall classify them as cash flows from operating activities unless they can be specifically identified with financing and investing activities. When tax cash flows are allocated over more than one class of activity, the entity shall disclose the total amount of taxes paid.

Non-cash transactions

- 7.18 An entity shall exclude from the statement of cash flows investing and financing transactions that do not require the use of cash or cash equivalents. An entity shall disclose such transactions elsewhere in the **financial statements** in a way that provides all the relevant information about those investing and financing activities.

- 7.19 Many investing and financing activities do not have a direct impact on current cash flows even though they affect the capital and asset structure of an entity. The exclusion of non-cash transactions from the statement of cash flows is consistent with the objective of a statement of cash flows because these items do not involve cash flows in the current period. Examples of non-cash transactions are:
- (a) the acquisition of assets either by assuming directly related liabilities or by means of a finance lease.
 - (b) the acquisition of an entity by means of an equity issue.
 - (c) the conversion of debt to equity.

Components of cash and cash equivalents

- 7.20 An entity shall present the components of cash and cash equivalents and shall present a reconciliation of the amounts presented in the statement of cash flows to the equivalent items presented in the statement of financial position. However, an entity is not required to present this reconciliation if the amount of cash and cash equivalents presented in the statement of cash flows is identical to the amount similarly described in the statement of financial position.

Other disclosures

- 7.21 An entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the entity. Cash and cash equivalents held by an entity may not be available for use by the entity because of, among other reasons, foreign exchange controls or legal restrictions.

SECTION 8

NOTES TO THE FINANCIAL STATEMENTS

Scope of this section

- 8.1 This section sets out the principles underlying information that is to be presented in the **notes** to the financial statements and how to present it. Notes contain information in addition to that presented in the **statement of financial position**, **statement of comprehensive income**, **income statement** (if presented), combined **statement of income and retained earnings** (if presented), **statement of changes in equity**, and **statement of cash flows**. Notes provide narrative descriptions or disaggregations of items presented in those statements and information about items that do not qualify for **recognition** in those statements. In addition to the requirements of this section, nearly every other section of this [draft] FRS requires disclosures that are normally presented in the notes.

Structure of the notes

- 8.2 The notes shall:
- (a) present information about the basis of preparation of the financial statements and the specific **accounting policies** used, in accordance with paragraphs 8.5–8.7;
 - (b) disclose the information required by this [draft] FRS that is not presented elsewhere in the financial statements; and
 - (c) provide information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them.
- 8.3 An entity shall, as far as practicable, present the notes in a systematic manner. An entity shall cross-reference each item in the financial statements to any related information in the notes.
- 8.4 An entity normally presents the notes in the following order:
- (a) a statement that the financial statements have been prepared in compliance with this [draft] FRS (see paragraph 3.3);
 - (b) a summary of significant accounting policies applied (see paragraph 8.5);
 - (c) supporting information for items presented in the financial statements, in the sequence in which each statement and each line item is presented; and
 - (d) any other disclosures.

Disclosure of accounting policies

- 8.5 An entity shall disclose the following in the summary of significant accounting policies:
- (a) the measurement basis (or bases) used in preparing the financial statements.
 - (b) the other accounting policies used that are relevant to an understanding of the financial statements.

Information about judgements

- 8.6 An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 8.7), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Information about key sources of estimation uncertainty

- 8.7 An entity shall disclose in the notes information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:
- (a) their nature.
 - (b) their carrying amount as at the end of the reporting period.

SECTION 9

CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

Scope of this section

- 9.1 This section applies to all **parents** that present **consolidated financial statements** (which can also be called group accounts) intended to give a true and fair view of the financial position and profit or loss (or income and expenditure) of their **group**, whether or not they report under the **Act**. Parents that do not report under the Act should comply with the requirements of this section, and of the Act where referred to in this section, except to the extent that these requirements are not permitted by any statutory framework under which such entities report. This section also includes guidance on **separate financial statements** and **combined financial statements**.

Requirement to present consolidated financial statements

- 9.2 Except as permitted or required by paragraph 9.3, a parent entity shall present consolidated financial statements in which it consolidates all its investments in **subsidiaries** in accordance with this [draft] FRS.
- 9.3 A parent is exempt from the requirement to prepare consolidated financial statements on any one of the following grounds.
- (a) The parent is a wholly-owned subsidiary and its immediate parent is established under the law of an EEA State. Exemption is conditional on compliance with certain further conditions set out in section 400(2) of the Act. A parent is not exempt if any of its securities are admitted to trading on a regulated market of any EEA State within the meaning of Council Directive 93/22/EEC.
 - (b) The parent is a majority-owned subsidiary and meets all the conditions for exemption as a wholly-owned subsidiary set out in section 400(2) of the Act as well as the additional conditions set out in section 400(1)(b) of the Act.
 - (c) The parent is a wholly-owned subsidiary of another entity and that parent is not established under the law of an EEA State. Exemption is conditional on compliance with certain further conditions set out in section 401(2) of the Act. The exemption does not apply to a parent if any of its securities are admitted to trading on a regulated market of any EEA State.
 - (d) The parent is a majority-owned subsidiary and meets all of the conditions for exemption as a wholly-owned subsidiary set out in section 401(2) of the Act as well as the additional conditions set out in section 401(1)(b) of the Act.
 - (e) All of the parent's subsidiaries are permitted or required to be excluded from consolidation by paragraph 9.9.
- 9.4 A subsidiary is an entity that is controlled by the parent. **Control** is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

- 9.5 Control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity. That presumption may be overcome in exceptional circumstances if it can be clearly demonstrated that such ownership does not constitute control. Control also exists when the parent owns half or less of the voting power of an entity but it has:
- (a) power over more than half of the voting rights by virtue of an agreement with other investors;
 - (b) power to govern the financial and operating policies of the entity under a statute or an agreement;
 - (c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body; or
 - (d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body.
- 9.6 Control can also be achieved by having options or convertible instruments that are currently exercisable or by having an agent with the ability to direct the activities for the benefit of the controlling entity.
- 9.7 [Not used]
- 9.8 A subsidiary is not excluded from consolidation because its business activities are dissimilar to those of the other entities within the consolidation. Relevant information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries.
- 9.9 A subsidiary should be excluded from consolidation where:
- (a) severe long-term restrictions substantially hinder the exercise of the rights of the parent over the assets or management of the subsidiary; or
 - (b) the interest in the subsidiary is **held exclusively with a view to subsequent resale** and the subsidiary has not previously been consolidated in the consolidated financial statements.
- 9.9A A subsidiary meeting the requirements of paragraph 9.9(b) and held as part of an investment portfolio shall be measured at fair value with changes in fair value recognised in profit or loss. A subsidiary is held as part of an investment portfolio if its value to the investor is through fair value as part of a directly or indirectly held basket of investments rather than as media through which the investor carries out business. A basket of investments is indirectly held if an investment fund holds a single investment in a second investment fund which, in turn, holds a basket of investments.
- 9.9B A subsidiary excluded from consolidation on the grounds set out in paragraph 9.9, except for those held as part of an investment portfolio, shall select a policy of accounting in accordance with paragraph 9.26.

Special purpose entities

- 9.10 An entity may be created to accomplish a narrow objective (eg to effect a lease, undertake research and development activities, securitise financial assets or facilitate employee shareholdings under remuneration schemes, such as Employee Share Ownership Plans (ESOPs)). Such a special purpose entity (SPE) may take the form of a corporation, trust, partnership or unincorporated entity. Often, SPEs are created with legal arrangements that impose strict requirements over the operations of the SPE.

- 9.11 Except as permitted or required by paragraph 9.3, a parent entity shall prepare consolidated financial statements that include the entity and any SPEs that are controlled by that entity. In addition to the circumstances described in paragraph 9.5, the following circumstances may indicate that an entity controls an SPE (this is not an exhaustive list):
- (a) the activities of the SPE are being conducted on behalf of the entity according to its specific business needs.
 - (b) the entity has the ultimate decision-making powers over the activities of the SPE even if the day-to-day decisions have been delegated.
 - (c) the entity has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incidental to the activities of the SPE.
 - (d) the entity retains the majority of the residual or ownership risks related to the SPE or its assets.
- 9.12 Paragraphs 9.10 and 9.11 do not apply to post-employment benefit plans or other long-term employee benefit plans to which Section 28 *Employee Benefits* applies. Section 28 does not apply to share-based payments, consequently plans related to such arrangements are consolidated in accordance with paragraph 9.11.

Consolidation procedures

- 9.13 The consolidated financial statements present financial information about the **group** as a single economic entity. In preparing consolidated financial statements, an entity shall:
- (a) combine the financial statements of the parent and its subsidiaries line by line by adding together like items of assets, liabilities, equity, income and expenses;
 - (b) eliminate the **carrying amount** of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary;
 - (c) measure and present **non-controlling interest** in the profit or loss of consolidated subsidiaries for the **reporting period** separately from the interest of the **owners** of the parent; and
 - (d) measure and present non-controlling interest in the net assets of consolidated subsidiaries separately from the parent shareholders' equity in them. Non-controlling interest in the net assets consists of:
 - (i) the amount of the non-controlling interest at the date of the original combination calculated in accordance with Section 19 *Business Combinations and Goodwill*, and
 - (ii) the non-controlling interest's share of changes in equity since the date of the combination.
- 9.14 The proportions of profit or loss and changes in equity allocated to the owners of the parent and to the non-controlling interest are determined on the basis of existing ownership interests and do not reflect the possible exercise or conversion of options or convertible instruments.

Intragroup balances and transactions

- 9.15 Intragroup balances and transactions, including income, expenses and dividends, are eliminated in full. Profits and losses resulting from intragroup transactions that are recognised in assets, such as inventory and property, plant and equipment, are eliminated in full. Intragroup losses may indicate an impairment that requires **recognition** in the consolidated financial statements

(see Section 27 *Impairment of Assets*). Section 29 *Income Tax* applies to deferred tax differences that arise from the elimination of profits and losses resulting from intragroup transactions.

Uniform reporting date

- 9.16 The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall be prepared as of the same **reporting date**. Where the reporting date of a subsidiary differs from that of the parent, the consolidated financial statements must be made up:
- (a) from the financial statements of the subsidiary from its last reporting date before the parent's reporting date, provided that reporting date is no more than three months before that of the parent; or
 - (b) from interim financial statements prepared by the subsidiary as at the parent's reporting date.

Uniform accounting policies

- 9.17 Consolidated financial statements shall be prepared using uniform **accounting policies** for like transactions and other events and conditions in similar circumstances. If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements in preparing the consolidated financial statements.

Acquisition and disposal of subsidiaries

- 9.18 The income and expenses of a subsidiary are included in the consolidated financial statements from the acquisition date. The income and expenses of a subsidiary are included in the consolidated financial statements until the date on which the parent ceases to control the subsidiary.

- 9.18A The difference between:

- (a) the sum of the proceeds received from the disposal plus the fair value of any retained interest, and
- (b) the carrying amount as of the date of disposal, excluding the cumulative amount of any exchange differences that relate to a foreign subsidiary recognised in equity in accordance with Section 30 *Foreign Currency Translation*

is recognised in the consolidated statement of comprehensive income (or the income statement, if presented) as the gain or loss on the disposal of the subsidiary. The cumulative amount of any exchange differences that relate to a foreign subsidiary recognised in equity in accordance with Section 30 *Foreign Currency Translation* is not recognised in profit or loss on disposal of the subsidiary.

- 9.19 If an entity ceases to be a subsidiary but the investor (former parent) continues to hold an investment in the former subsidiary, that investment shall be accounted for as a **financial asset** in accordance with Section 11 *Basic Financial Instruments* or Section 12 *Other Financial Instruments Issues* from the date the entity ceases to be a subsidiary, provided that it does not become an **associate** (in which case Section 14 *Investments in Associates* applies) or a **jointly controlled entity** (in which case Section 15 *Investments in Joint Ventures* applies). The fair value of the retained investment at the date that the entity ceases to be a subsidiary shall be regarded as the cost on initial measurement of the financial asset.

Non-controlling interest in subsidiaries

- 9.20 An entity shall present non-controlling interest in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent.
- 9.21 An entity shall disclose non-controlling interest in the profit or loss of the group separately in the statement of comprehensive income.
- 9.22 Profit or loss and each component of other comprehensive income shall be attributed to the owners of the parent and to the non-controlling interest. Total comprehensive income shall be attributed to the owners of the parent and to the non-controlling interest even if this results in the non-controlling interest having a deficit balance.

Disclosures in consolidated financial statements

- 9.23 The following disclosures shall be made in consolidated financial statements:
- (a) the fact that the statements are consolidated financial statements.
 - (b) the basis for concluding that control exists when the parent does not own, directly or indirectly through subsidiaries, more than half of the voting power.
 - (c) any difference in the reporting date of the financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements.
 - (d) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements or regulatory requirements) on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends or to repay loans.
 - (e) the name of any subsidiary excluded from consolidation and the reason for exclusion.

Separate financial statements

Presentation of separate financial statements

- 9.24 Separate financial statements are those presented by a parent in which the investments in subsidiaries, associates or jointly controlled entities are accounted for either at cost or fair value rather than on the basis of the reported results and net assets of the investees. The requirements for the presentation of separate financial statements are set out in the Act or relevant legislation.
- 9.25 An entity that is not a parent accounts for any investments in associates and any interests in jointly controlled entities in accordance with paragraph 14.4 or 15.9, as appropriate. An entity that is not a parent but facilitates employee shareholdings under remuneration schemes, such as Employees Share Ownership Plans (ESOPs) applies paragraphs 2.53 to 2.55 to such arrangements.

Accounting policy election

- 9.26 When a parent prepares separate financial statements and describes them as conforming to this [draft] FRS, those financial statements shall comply with all of the requirements of this [draft] FRS. The parent shall adopt a policy of accounting for its investments in subsidiaries, associates and jointly controlled entities either:
- (a) at cost less impairment,
 - (b) at **fair value** with changes in fair value recognised in accordance with paragraphs 17.15E and 17.15F, or
 - (c) at fair value with changes in fair value recognised in profit or loss.

The entity shall apply the same accounting policy for all investments in a single class (subsidiaries, associates or jointly controlled entities), but it can elect different policies for different classes.

- 9.26A A parent that is exempt in accordance with paragraph 9.3 from the requirement to present consolidated financial statements, and presents separate financial statements as its only financial statements, shall account for its investments in subsidiaries, associates and jointly controlled entities in accordance with paragraph 9.26.

Disclosures in separate financial statements

- 9.27 When a parent prepares separate financial statements, those separate financial statements shall disclose:
- (a) that the statements are separate financial statements, and
 - (b) a description of the methods used to account for the investments in subsidiaries, jointly controlled entities and associates.
- 9.27A A parent that uses one of the exemptions from presenting consolidated financial statements (described in paragraph 9.3) shall disclose the grounds on which the parent is exempt.
- 9.27B When a parent adopts a policy of accounting for its investments in subsidiaries, associates or jointly controlled entities at fair value with changes in fair value recognised in profit or loss, it must comply with the requirements, in respect of those investments, of paragraph 36(4) of Schedule 1 to the Regulations, by applying the disclosure requirements of paragraph 11.48A.

Combined financial statements

- 9.28 Combined financial statements are a single set of financial statements of two or more entities controlled by a single investor. This [draft] FRS does not require combined financial statements to be prepared.
- 9.29 If the investor prepares combined financial statements and describes them as conforming to this [draft] FRS, those statements shall comply with all of the requirements of this [draft] FRS. Intercompany transactions and balances shall be eliminated; profits or losses resulting from intercompany transactions that are recognised in assets such as inventory and property, plant and equipment shall be eliminated; the financial statements of the entities included in the combined financial statements shall be prepared as of the same reporting date unless it is impracticable to do so; and uniform accounting policies shall be followed for like transactions and other events in similar circumstances.

Disclosures in combined financial statements

- 9.30 The combined financial statements shall disclose the following:
- (a) the fact that the financial statements are combined financial statements.
 - (b) the reason why combined financial statements are prepared.
 - (c) the basis for determining which entities are included in the combined financial statements.
 - (d) the basis of preparation of the combined financial statements.
 - (e) the **related party** disclosures required by Section 33 *Related Party Disclosures*.

Exchanges of businesses or other non-monetary assets for an interest in a subsidiary, joint venture or associate

9.31 Where a reporting entity exchanges a business (or other non-monetary assets) for an interest in another entity, and that other entity thereby becomes a subsidiary, joint venture or associate of the reporting entity, the following accounting treatment should apply in the consolidated financial statements of the reporting entity:

- (a) to the extent that the reporting entity retains an ownership interest in the business (or other non-monetary assets) exchanged, even if that interest is then held through the other entity, that retained interest, including any related goodwill is treated as having been owned by the reporting entity throughout the transaction and should be included at its pre-transaction carrying amount.
- (b) goodwill should be recognised as the difference between:
 - (i) the fair value of the consideration given; and
 - (ii) the fair value of the reporting entity's share of the pre-transaction net assets of the other entity.

The consideration given for the interest acquired in the other entity will include that part of the business (or other non-monetary assets) exchanged and no longer owned by the reporting entity. The consideration may also include cash or monetary assets to achieve equalisation of values. Where it is difficult to value the consideration given, the best estimate of its value may be given by valuing what is acquired.

- (c) to the extent that the fair value of the consideration received by the reporting entity exceeds the book value of the part of the business (or other non-monetary assets) no longer owned by the reporting entity (and any related goodwill) together with any cash given up, the reporting entity should recognise a gain.
 - (d) where the fair value of the consideration received by the reporting entity exceeds the book value of the part of the business (or other non-monetary assets) no longer owned by the reporting entity (and any related goodwill) together with any cash given up, the reporting entity should recognise a loss, either as an impairment in accordance with Section 27 *Impairment of Assets* or, for any loss remaining after an impairment review of the relevant assets, in profit or loss.
- 9.32 No gain or loss should be recognised in those rare cases where the artificiality or lack of substance of the transaction is such that a gain or loss on the exchange could not be justified. For example, an exchange might purport to give rise to a recognisable gain even though the assets exchanged would be unlikely otherwise to be saleable. Where a gain or loss on the exchange is not taken into account because the transaction is artificial or has no substance, the circumstances should be explained.

SECTION 10

ACCOUNTING POLICIES, ESTIMATES AND ERRORS

Scope of this section

- 10.1 This section provides guidance for selecting and applying the **accounting policies** used in preparing **financial statements**. It also covers **changes in accounting estimates** and corrections of **errors** in prior period financial statements.

Selection and application of accounting policies

- 10.2 Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
- 10.3 If this [draft] FRS specifically addresses a transaction, other event or condition, an entity shall apply this [draft] FRS. However, the entity need not follow a requirement in this [draft] FRS if the effect of doing so would not be **material**.
- 10.4 If this [draft] FRS does not specifically address a transaction, other event or condition, an entity's management shall use its judgement in developing and applying an accounting policy that results in information that is:
- (a) **relevant** to the economic decision-making needs of users, and
 - (b) **reliable**, in that the financial statements:
 - (i) represent faithfully the **financial position**, financial **performance** and **cash flows** of the entity;
 - (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
 - (iii) are neutral, ie free from bias;
 - (iv) are prudent; and
 - (v) are complete in all material respects.
- 10.5 In making the judgement described in paragraph 10.4, management shall refer to, and consider the applicability of, the following sources in descending order:
- (a) the requirements and guidance in this [draft] FRS dealing with similar and related issues;
 - (b) where an entity's financial statements are within the scope of a **Statement of Recommended Practice (SORP)** the requirements and guidance in that SORP dealing with similar and related issues; and
 - (c) the definitions, **recognition** criteria and **measurement** concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 *Concepts and Pervasive Principles*.
- 10.6 In making the judgement described in paragraph 10.4, management may also consider the requirements and guidance in **EU-adopted IFRS** dealing with similar and related issues. Paragraph 1.3–1.6 requires certain entities to apply, IAS 33 *Earnings per Share* (as adopted in the

EU), IAS 34 *Interim Financial Reporting* (as adopted in the EU), IFRS 4 *Insurance Contracts* (as adopted in the EU) or IFRS 8 *Operating Segments* (as adopted in the EU).

Consistency of accounting policies

- 10.7 An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless this [draft] FRS specifically requires or permits categorisation of items for which different policies may be appropriate. If this [draft] FRS requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category.

Changes in accounting policies

- 10.8 An entity shall change an accounting policy only if the change:
- (a) is required by changes to this [draft] FRS, or
 - (b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.
- 10.9 The following are not changes in accounting policies:
- (a) the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring.
 - (b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or were not material.
 - (c) a change to the cost model when a reliable measure of fair value is no longer available (or vice versa) for an asset that this [draft] FRS would otherwise require or permit to be measured at fair value.
- 10.10 If this [draft] FRS allows a choice of accounting treatment (including the measurement basis) for a specified transaction or other event or condition and an entity changes its previous choice, that is a change in accounting policy.

Applying changes in accounting policies

- 10.11 An entity shall account for changes in accounting policy as follows:
- (a) an entity shall account for a change in accounting policy resulting from a change in the requirements of this [draft] FRS in accordance with the transitional provisions, if any, specified in that amendment;
 - (b) when an entity has elected to follow IAS 39 *Financial Instruments: Recognition and Measurement* instead of following Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues* as permitted by paragraph 11.2, and the requirements of IAS 39 change, the entity shall account for that change in accounting policy in accordance with the transitional provisions, if any, specified in the revised IAS 39; and
 - (c) an entity shall account for all other changes in accounting policy **retrospectively** (see paragraph 10.12).

Retrospective application

- 10.12 When a change in accounting policy is applied retrospectively in accordance with paragraph 10.11, the entity shall apply the new accounting policy to comparative information for prior periods to the earliest date for which it is practicable, as if the new accounting policy had always been applied. When it is **impracticable** to determine the individual-period effects of a change in accounting policy on comparative information for one or more prior periods presented, the entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of equity for that period.

Disclosure of a change in accounting policy

- 10.13 When an amendment to this [draft] FRS has an effect on the current period or any prior period, or might have an effect on future periods, an entity shall disclose the following:
- (a) the nature of the change in accounting policy.
 - (b) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected.
 - (c) the amount of the adjustment relating to periods before those presented, to the extent practicable.
 - (d) an explanation if it is impracticable to determine the amounts to be disclosed in (b) or (c) above.

Financial statements of subsequent periods need not repeat these disclosures.

- 10.14 When a voluntary change in accounting policy has an effect on the current period or any prior period, an entity shall disclose the following:
- (a) the nature of the change in accounting policy.
 - (b) the reasons why applying the new accounting policy provides reliable and more relevant information.
 - (c) to the extent practicable, the amount of the adjustment for each financial statement line item affected, shown separately:
 - (i) for the current period;
 - (ii) for each prior period presented; and
 - (iii) in the aggregate for periods before those presented.
 - (d) an explanation if it is impracticable to determine the amounts to be disclosed in (c) above.

Financial statements of subsequent periods need not repeat these disclosures.

Changes in accounting estimates

- 10.15 A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments

and, accordingly, are not corrections of errors. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.

- 10.16 An entity shall recognise the effect of a change in an accounting estimate, other than a change to which paragraph 10.17 applies, **prospectively** by including it in profit or loss in:
- (a) the period of the change, if the change affects that period only, or
 - (b) the period of the change and future periods, if the change affects both.
- 10.17 To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, the entity shall recognise it by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.

Disclosure of a change in estimate

- 10.18 An entity shall disclose the nature of any change in an accounting estimate and the effect of the change on assets, liabilities, income and expense for the current period. If it is practicable for the entity to estimate the effect of the change in one or more future periods, the entity shall disclose those estimates.

Corrections of prior period errors

- 10.19 Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:
- (a) was available when financial statements for those periods were authorised for issue, and
 - (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.
- 10.20 Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.
- 10.21 To the extent practicable, an entity shall correct a material prior period error retrospectively in the first financial statements authorised for issue after its discovery by:
- (a) restating the comparative amounts for the prior period(s) presented in which the error occurred, or
 - (b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.
- 10.22 When it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, the entity shall restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable (which may be the current period).

Disclosure of prior period errors

10.23 An entity shall disclose the following about prior period errors:

- (a) the nature of the prior period error.
- (b) for each prior period presented, to the extent practicable, the amount of the correction for each financial statement line item affected.
- (c) to the extent practicable, the amount of the correction at the beginning of the earliest prior period presented.
- (d) an explanation if it is not practicable to determine the amounts to be disclosed in (b) or (c) above.

Financial statements of subsequent periods need not repeat these disclosures.

The ASB explains in part 1 of the FREDs its intention to issue a supplementary exposure draft when the IASB finalises the requirements of IFRS 9 *Financial Instruments*. The supplementary exposure will propose changes to sections 11 and 12, those paragraphs most likely to change are shaded.

SECTION 11

BASIC FINANCIAL INSTRUMENTS

Scope of Sections 11 and 12

11.1 Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues* together deal with recognising, derecognising, measuring and disclosing **financial instruments** (**financial assets** and **financial liabilities**). Section 11 applies to basic financial instruments and is relevant to all entities. Section 12 applies to other, more complex financial instruments and transactions. If an entity enters into only basic financial instrument transactions then Section 12 is not applicable. However, even entities with only basic financial instruments shall consider the scope of Section 12 to ensure they are exempt.

PBE11.1 Public benefit entities that make or receive **concessionary loans** shall refer to the relevant paragraphs of Section 34 *Specialised Activities* for details on how to account for such loans.

Accounting policy choice

11.2 An entity shall choose to apply either:

- (a) the provisions of both Section 11 and Section 12 in full, or
- (b) the recognition and measurement provisions of IAS 39 *Financial Instruments: Recognition and Measurement*/IFRS 9 *Financial Instruments* (as adopted in the EU) and the disclosure requirements of Sections 11 and 12.

to account for all of its financial instruments. An entity's choice of (a) or (b) is an accounting policy choice. Paragraphs 10.8–10.14 contain requirements for determining when a change in accounting policy is appropriate, how such a change should be accounted for, and what information should be disclosed about the change.

Introduction to Section 11

11.3 A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

11.4 Section 11 requires an amortised cost model for all basic financial instruments except for investments in non-convertible and non-puttable preference shares and non-puttable ordinary shares that are **publicly traded** or whose fair value can otherwise be measured reliably.

11.5 Basic financial instruments within the scope of Section 11 are those that satisfy the conditions in paragraph 11.8. Examples of financial instruments that normally satisfy those conditions include:

- (a) cash.
- (b) demand and fixed-term deposits when the entity is the depositor, eg bank accounts.

- (c) commercial paper and commercial bills held.
 - (d) accounts, notes and loans receivable and payable.
 - (e) bonds and similar debt instruments.
 - (f) investments in non-convertible preference shares and non-puttable ordinary and preference shares.
 - (g) commitments to receive a loan if the commitment cannot be net settled in cash.
- 11.6 Examples of financial instruments that do not normally satisfy the conditions in paragraph 11.8, and are therefore within the scope of Section 12, include:
- (a) asset-backed securities, such as collateralised mortgage obligations, repurchase agreements and securitised packages of receivables.
 - (b) options, rights, warrants, futures contracts, forward contracts and interest rate swaps that can be settled in cash or by exchanging another financial instrument.
 - (c) financial instruments that qualify and are designated as hedging instruments in accordance with the requirements in Section 12.
 - (d) commitments to make a loan to another entity.
 - (e) commitments to receive a loan if the commitment can be net settled in cash.

Scope of Section 11

- 11.7 Section 11 applies to all financial instruments meeting the conditions of paragraph 11.8 except for the following:
- (a) investments in **subsidiaries, associates and joint ventures** that are accounted for in accordance with Section 9 *Consolidated and Separate Financial Statements*, Section 14 *Investments in Associates* or Section 15 *Investments in Joint Ventures*.
 - (b) financial instruments that meet the definition of an entity's own equity (see Section 22 *Liabilities and Equity* and Section 26 *Share-based Payment*).
 - (c) leases, to which Section 20 *Leases* applies. However, the derecognition requirements in paragraphs 11.33–11.38 apply to derecognition of lease receivables recognised by a lessor and lease payables recognised by a lessee. Also, Section 12 may apply to leases with characteristics specified in paragraph 12.3(f).
 - (d) employers' rights and obligations under employee benefit plans, to which Section 28 *Employee Benefits* applies.
 - (e) financial instruments, contracts and obligations to which Section 26 *Share-based Payment* applies, except for contracts within the scope of paragraph 12.5 of this [draft] FRS.
 - (f) **insurance contracts** (including **reinsurance contracts**) that it issues and reinsurance contracts that it holds.
 - (g) financial instruments issued by an entity with a **discretionary participation feature**.

A reporting entity that issues or holds financial instruments set out in (f) and (g) is required by paragraph 1.4 to apply IFRS 4 *Insurance Contracts* (as adopted in the EU).

Basic financial instruments

- 11.8 An entity shall account for the following financial instruments as basic financial instruments in accordance with Section 11:
- (a) cash.
 - (b) a debt instrument (such as an account, note, or loan receivable or payable) that meets the conditions in paragraph 11.9.
 - (c) a commitment to receive a loan that:
 - (i) cannot be settled net in cash, and
 - (ii) when the commitment is executed, is expected to meet the conditions in paragraph 11.9.
 - (d) an investment in non-convertible preference shares and non-puttable ordinary shares or preference shares.
- 11.9 A debt instrument that satisfies all of the conditions in (a)–(d) below shall be accounted for in accordance with Section 11:
- (a) Returns to the holder are
 - (i) a fixed amount;
 - (ii) a fixed rate of return over the life of the instrument;
 - (iii) a variable return that, throughout the life of the instrument, is equal to a single referenced quoted or observable interest rate (such as LIBOR); or
 - (iv) some combination of such fixed rate and variable rates (such as LIBOR plus 200 basis points), provided that both the fixed and variable rates are positive (eg an interest rate swap with a positive fixed rate and negative variable rate would not meet this criterion). For fixed and variable rate interest returns, interest is calculated by multiplying the rate for the applicable period by the principal amount outstanding during the period.
 - (b) There is no contractual provision that could, by its terms, result in the holder losing the principal amount or any interest attributable to the current period or prior periods. The fact that a debt instrument is subordinated to other debt instruments is not an example of such a contractual provision.
 - (c) Contractual provisions that permit the issuer (the borrower) to prepay a debt instrument or permit the holder (the lender) to put it back to the issuer before maturity are not contingent on future events other than to protect:
 - (i) the holder against the credit deterioration of the issuer (eg defaults, credit downgrades or loan covenant violations), or a change in control of the issuer; or
 - (ii) the holder or issuer against changes in relevant taxation or law.
 - (d) There are no conditional returns or repayment provisions except for the variable rate return described in (a) and prepayment provisions described in (c).

- 11.10 Examples of financial instruments that would normally satisfy the conditions in paragraph 11.9 are:
- (a) trade accounts and notes receivable and payable, and loans from banks or other third parties.
 - (b) accounts payable in a foreign currency. However, any change in the account payable because of a change in the exchange rate is recognised in profit or loss as required by paragraph 30.10.
 - (c) loans to or from subsidiaries or associates that are due on demand.
 - (d) a debt instrument that would become immediately receivable if the issuer defaults on an interest or principal payment (such a provision does not violate the conditions in paragraph 11.9).
- 11.11 Examples of financial instruments that do not satisfy the conditions in paragraph 11.9 (and are therefore within the scope of Section 12) include:
- (a) an investment in another entity's equity instruments other than non-convertible preference shares and non-puttable ordinary and preference shares (see paragraph 11.8(d)).
 - (b) an interest rate swap that returns a cash flow that is positive or negative, or a forward commitment to purchase a commodity or financial instrument that is capable of being cash-settled and that, on settlement, could have positive or negative cash flow, because such swaps and forwards do not meet the condition in paragraph 11.9(a).
 - (c) options and forward contracts, because returns to the holder are not fixed and the condition in paragraph 11.9(a) is not met.
 - (d) investments in convertible debt, because the return to the holder can vary with the price of the issuer's equity shares rather than just with market interest rates.
 - (e) not used.

Initial recognition of financial assets and liabilities

- 11.12 An entity shall recognise a financial asset or a financial liability only when the entity becomes a party to the contractual provisions of the instrument.

Initial measurement

- 11.13 When a financial asset or financial liability is recognised initially, an entity shall measure it at the transaction price (including transaction costs except in the initial measurement of financial assets and liabilities that are measured at fair value through profit or loss) unless the arrangement constitutes, in effect, a financing transaction. A financing transaction may take place in connection with the sale of goods or services, for example, if payment is deferred beyond normal business terms or is financed at a rate of interest that is not a market rate. If the arrangement constitutes a financing transaction, the entity shall measure the financial asset or financial liability at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.

Examples – financial assets	
1	For a long-term loan made to another entity, a receivable is recognised at the present value of cash receivable (including interest payments and repayment of principal) from that entity.
2	For goods sold to a customer on short-term credit, a receivable is recognised at the undiscounted amount of cash receivable from that entity, which is normally the invoice price.
3	For an item sold to a customer on two-year interest-free credit, a receivable is recognised at the current cash sale price for that item. If the current cash sale price is not known, it may be estimated as the present value of the cash receivable discounted using the prevailing market rate(s) of interest for a similar receivable.
4	For a cash purchase of another entity's ordinary shares, the investment is recognised at the amount of cash paid to acquire the shares.

Examples – financial liabilities	
1	For a loan received from a bank, a payable is recognised initially at the present value of cash payable to the bank (eg including interest payments and repayment of principal).
2	For goods purchased from a supplier on short-term credit, a payable is recognised at the undiscounted amount owed to the supplier, which is normally the invoice price.

Subsequent measurement

11.14 At the end of each **reporting period**, an entity shall measure financial instruments as follows, without any deduction for transaction costs the entity may incur on sale or other disposal:

- (a) Debt instruments that meet the conditions in paragraph 11.8(b) shall be measured at **amortised cost** using the **effective interest method**. Paragraphs 11.15–11.20 provide guidance on determining amortised cost using the effective interest method. Debt instruments that are classified as payable or receivable within one year shall be measured at the undiscounted amount of the cash or other consideration expected to be paid or received (ie net of impairment—see paragraphs 11.21–11.26) unless the arrangement constitutes, in effect, a financing transaction (see paragraph 11.13). If the arrangement constitutes a financing transaction, the entity shall measure the debt instrument at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.
- (b) Commitments to receive a loan that meet the conditions in paragraph 11.8(c) shall be measured at cost (which sometimes is nil) less impairment.
- (c) Investments in non-convertible preference shares and non-puttable ordinary or preference shares that meet the conditions in paragraph 11.8(d) shall be measured as follows (paragraphs 11.27–11.32 provide guidance on fair value):
 - (i) if the shares are publicly traded or their fair value can otherwise be measured reliably, the investment shall be measured at fair value with changes in fair value recognised in profit or loss.
 - (ii) all other such investments shall be measured at cost less impairment.

Impairment or uncollectibility must be assessed for financial instruments in (a), (b) and (c)(ii) above. Paragraphs 11.21–11.26 provide guidance.

Amortised cost and effective interest method

11.15 The amortised cost of a financial asset or financial liability at each reporting date is the net of the following amounts:

- (a) the amount at which the financial asset or financial liability is measured at initial recognition,
- (b) minus any repayments of the principal,
- (c) plus or minus the cumulative amortisation using the effective interest method of any difference between the amount at initial recognition and the maturity amount,
- (d) minus, in the case of a financial asset, any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.

Financial assets and financial liabilities that have no stated interest rate and are classified as payable or receivable within one year are initially measured at an undiscounted amount in accordance with paragraph 11.14(a). Therefore, (c) above does not apply to them.

11.16 The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (or a group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the carrying amount of the financial asset or financial liability. The effective interest rate is determined on the basis of the carrying amount of the financial asset or liability at initial recognition. Under the effective interest method:

- (a) the amortised cost of a financial asset (liability) is the present value of future cash receipts (payments) discounted at the effective interest rate, and
- (b) the interest expense (income) in a period equals the carrying amount of the financial liability (asset) at the beginning of a period multiplied by the effective interest rate for the period.

11.17 When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (eg prepayment, call and similar options) and known credit losses that have been incurred, but it shall not consider possible future credit losses not yet incurred.

11.18 When calculating the effective interest rate, an entity shall amortise any related fees, finance charges paid or received (such as 'points'), transaction costs and other premiums or discounts over the expected life of the instrument, except as follows. The entity shall use a shorter period if that is the period to which the fees, finance charges paid or received, transaction costs, premiums or discounts relate. This will be the case when the variable to which the fees, finance charges paid or received, transaction costs, premiums or discounts relate is repriced to market rates before the expected maturity of the instrument. In such a case, the appropriate amortisation period is the period to the next such repricing date.

11.19 For variable rate financial assets and variable rate financial liabilities, periodic re-estimation of cash flows to reflect changes in market rates of interest alters the effective interest rate. If a variable rate financial asset or variable rate financial liability is recognised initially at an amount equal to the principal receivable or payable at maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or liability.

11.20 If an entity revises its estimates of payments or receipts, the entity shall adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect

actual and revised estimated cash flows. The entity shall recalculate the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate. The entity shall recognise the adjustment as income or expense in profit or loss at the date of the revision.

Example of determining amortised cost for a five-year loan using the effective interest method

On 1 January 20X0, an entity acquires a bond for Currency Units (CU)900, incurring transaction costs of CU50. Interest of CU40 is receivable annually, in arrears, over the next five years (31 December 20X0–31 December 20X4). The bond has a mandatory redemption of CU1100 on 31 December 20X4.

Year	Carrying amount at beginning of period	Interest income at 6.9583%*	Cash inflow	Carrying amount at end of period
	CU	CU	CU	CU
20X0	950.00	66.10	(40.00)	976.11
20X1	976.11	67.92	(40.00)	1,004.03
20X2	1,004.03	69.86	(40.00)	1,033.89
20X3	1,033.89	71.94	(40.00)	1,065.83
20X4	1,065.83	74.16	(40.00)	1,100.00
			(1,100.00)	0
<p>* The effective interest rate of 6.9583 per cent is the rate that discounts the expected cash flows on the bond to the initial carrying amount:</p> $40/(1.069583)^1 + 40/(1.069583)^2 + 40/(1.069583)^3 + 40/(1.069583)^4 + 1,140/(1.069583)^5 = 950$				

Impairment of financial instruments measured at cost or amortised cost

Recognition

- 11.21 At the end of each **reporting period**, an entity shall assess whether there is objective evidence of impairment of any financial assets that are measured at cost or amortised cost. If there is objective evidence of impairment, the entity shall recognise an **impairment loss** in profit or loss immediately.
- 11.22 Objective evidence that a financial asset or group of assets is impaired includes observable data that come to the attention of the holder of the asset about the following loss events:
- (a) significant financial difficulty of the issuer or obligor.
 - (b) a breach of contract, such as a default or delinquency in interest or principal payments.
 - (c) the creditor, for economic or legal reasons relating to the debtor's financial difficulty, granting to the debtor a concession that the creditor would not otherwise consider.
 - (d) it has become **probable** that the debtor will enter bankruptcy or other financial reorganisation.

- (e) observable data indicating that there has been a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, even though the decrease cannot yet be identified with the individual financial assets in the group, such as adverse national or local economic conditions or adverse changes in industry conditions.

11.23 Other factors may also be evidence of impairment, including significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates.

11.24 An entity shall assess the following financial assets individually for impairment:

- (a) all equity instruments regardless of significance, and
- (b) other financial assets that are individually significant.

An entity shall assess other financial assets for impairment either individually or grouped on the basis of similar credit risk characteristics.

Measurement

11.25 An entity shall measure an impairment loss on the following instruments measured at cost or amortised cost as follows:

- (a) for an instrument measured at amortised cost in accordance with paragraph 11.14(a), the impairment loss is the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the asset's original effective interest rate. If such a financial instrument has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.
- (b) for an instrument measured at cost less impairment in accordance with paragraph 11.14(b) and (c)(ii) the impairment loss is the difference between the asset's carrying amount and the best estimate (which will necessarily be an approximation) of the amount (which might be zero) that the entity would receive for the asset if it were to be sold at the reporting date.

Reversal

11.26 If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the entity shall reverse the previously recognised impairment loss either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset (net of any allowance account) that exceeds what the carrying amount would have been had the impairment not previously been recognised. The entity shall recognise the amount of the reversal in profit or loss immediately.

Fair value

11.27 Paragraph 11.14(c)(i) requires an investment in ordinary shares or preference shares to be measured at fair value if the fair value of the shares can be measured reliably. An entity shall use the following hierarchy to estimate the fair value of the shares:

- (a) The best evidence of fair value is a quoted price for an identical asset in an active market. This is usually the current bid price.
- (b) When quoted prices are unavailable, the price of a recent transaction for an identical asset provides evidence of fair value as long as there has not been a significant change in economic circumstances or a significant lapse of time since the transaction took place. If

the entity can demonstrate that the last transaction price is not a good estimate of fair value (eg because it reflects the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), that price is adjusted.

- (c) If the market for the asset is not active and recent transactions of an identical asset on their own are not a good estimate of fair value, an entity estimates the fair value by using a valuation technique. The objective of using a valuation technique is to estimate what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations.

Other sections of this [draft] FRS make reference to the fair value guidance in paragraphs 11.27–11.32, including Section 12, Section 14, Section 15 and Section 16 *Investment Property*. In applying that guidance to assets covered by those sections, the reference to ordinary shares or preference shares in this paragraph should be read to include the types of assets covered by those sections.

Valuation technique

- 11.28 Valuation techniques include using recent arm's length market transactions for an identical asset between knowledgeable, willing parties, if available, reference to the current fair value of another asset that is substantially the same as the asset being measured, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the asset and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique.
- 11.29 The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations. Fair value is estimated on the basis of the results of a valuation technique that makes maximum use of market inputs, and relies as little as possible on entity-determined inputs. A valuation technique would be expected to arrive at a reliable estimate of the fair value if
 - (a) it reasonably reflects how the market could be expected to price the asset, and
 - (b) the inputs to the valuation technique reasonably represent market expectations and measures of the risk return factors inherent in the asset.

No active market: equity instruments

- 11.30 The fair value of investments in assets that do not have a quoted market price in an active market 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.
- 11.31 There are many situations in which the variability in the range of reasonable fair value estimates of assets that do not have a quoted market price is likely not to be significant. Normally it is possible to estimate the fair value of an asset that an entity has acquired from an outside party. However, if the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, an entity is precluded from measuring the asset at fair value.
- 11.32 If a reliable measure of fair value is no longer available for an asset measured at fair value (eg an equity instrument measured at fair value through profit or loss), its carrying amount at the last

date the asset was reliably measurable becomes its new cost. The entity shall measure the asset at this cost amount less impairment until a reliable measure of fair value becomes available.

Derecognition of a financial asset

11.33 An entity shall derecognise a financial asset only when:

- (a) the contractual rights to the cash flows from the financial asset expire or are settled, or
- (b) the entity transfers to another party substantially all of the risks and rewards of ownership of the financial asset, or
- (c) the entity, despite having retained some significant risks and rewards of ownership, has transferred control of the asset to another party and the other party has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer. In this case, the entity shall:
 - (i) derecognise the asset, and
 - (ii) recognise separately any rights and obligations retained or created in the transfer.

The carrying amount of the transferred asset shall be allocated between the rights or obligations retained and those transferred on the basis of their relative fair values at the transfer date. Newly created rights and obligations shall be measured at their fair values at that date. Any difference between the consideration received and the amounts recognised and derecognised in accordance with this paragraph shall be recognised in profit or loss in the period of the transfer.

11.34 If a transfer does not result in derecognition because the entity has retained significant risks and rewards of ownership of the transferred asset, the entity shall continue to recognise the transferred asset in its entirety and shall recognise a financial liability for the consideration received. The asset and liability shall not be offset. In subsequent periods, the entity shall recognise any income on the transferred asset and any expense incurred on the financial liability.

11.35 If a transferor provides non-cash collateral (such as debt or equity instruments) to the transferee, the accounting for the collateral by the transferor and the transferee depends on whether the transferee has the right to sell or repledge the collateral and on whether the transferor has defaulted. The transferor and transferee shall account for the collateral as follows:

- (a) If the transferee has the right by contract or custom to sell or repledge the collateral, the transferor shall reclassify that asset in its statement of financial position (eg as a loaned asset, pledged equity instruments or repurchase receivable) separately from other assets.
- (b) If the transferee sells collateral pledged to it, it shall recognise the proceeds from the sale and a liability measured at fair value for its obligation to return the collateral.
- (c) If the transferor defaults under the terms of the contract and is no longer entitled to redeem the collateral, it shall derecognise the collateral, and the transferee shall recognise the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognise its obligation to return the collateral.
- (d) Except as provided in (c), the transferor shall continue to carry the collateral as its asset, and the transferee shall not recognise the collateral as an asset.

Example-transfer that qualifies for derecognition

An entity sells a group of its accounts receivable to a bank at less than their face amount. The entity continues to handle collections from the debtors on behalf of the bank, including sending monthly statements, and the bank pays the entity a market-rate fee for servicing the receivables. The entity is obliged to remit promptly to the bank any and all amounts collected, but it has no obligation to the bank for slow payment or non-payment by the debtors. In this case, the entity has transferred to the bank substantially all of the risks and rewards of ownership of the receivables. Accordingly, it removes the receivables from its statement of financial position (ie derecognises them), and it shows no liability in respect of the proceeds received from the bank. The entity recognises a loss calculated as the difference between the carrying amount of the receivables at the time of sale and the proceeds received from the bank. The entity recognises a liability to the extent that it has collected funds from the debtors but has not yet remitted them to the bank.

Example-transfer that does not qualify for derecognition

The facts are the same as the preceding example except that the entity has agreed to buy back from the bank any receivables for which the debtor is in arrears as to principal or interest for more than 120 days. In this case, the entity has retained the risk of slow payment or non-payment by the debtors—a significant risk with respect to receivables. Accordingly, the entity does not treat the receivables as having been sold to the bank, and it does not derecognise them. Instead, it treats the proceeds from the bank as a loan secured by the receivables. The entity continues to recognise the receivables as an asset until they are collected or written off as uncollectible.

Derecognition of a financial liability

- 11.36 An entity shall derecognise a financial liability (or a part of a financial liability) only when it is extinguished—ie when the obligation specified in the contract is discharged, is cancelled or expires.
- 11.37 If an existing borrower and lender exchange financial instruments with substantially different terms, the entities shall account for the transaction as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, an entity shall account for a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) as an extinguishment of the original financial liability and the recognition of a new financial liability.
- 11.38 The entity shall recognise in profit or loss any difference between the carrying amount of the financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed.

Disclosures

- 11.39 The disclosures below make reference to disclosures for financial liabilities measured at fair value through profit or loss. Entities that have only basic financial instruments (and therefore do not apply Section 12) will not have any financial liabilities measured at fair value through profit or loss and hence will not need to provide such disclosures.

Disclosure of accounting policies for financial instruments

- 11.40 In accordance with paragraph 8.5, an entity shall disclose, in the summary of significant accounting policies, the measurement basis (or bases) used for financial instruments and the

other accounting policies used for financial instruments that are relevant to an understanding of the financial statements.

Statement of financial position – categories of financial assets and financial liabilities

- 11.41 An entity shall disclose the carrying amounts of each of the following categories of financial assets and financial liabilities at the reporting date, in total, either in the statement of financial position or in the notes:
- (a) financial assets measured at fair value through profit or loss (paragraph 11.14(c)(i) and paragraphs 12.8 and 12.9).
 - (b) financial assets that are debt instruments measured at amortised cost (paragraph 11.14(a)).
 - (c) financial assets that are equity instruments measured at cost less impairment (paragraph 11.14(c)(ii) and paragraphs 12.8 and 12.9).
 - (d) financial liabilities measured at fair value through profit or loss (paragraphs 12.8 and 12.9). Financial liabilities that are not held as part of a trading portfolio and are not derivatives shall be shown separately.
 - (e) financial liabilities measured at amortised cost (paragraph 11.14(a)).
 - (f) loan commitments measured at cost less impairment (paragraph 11.14(b)).
- 11.42 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. For example, for long-term debt such information would normally include the terms and conditions of the debt instrument (such as interest rate, maturity, repayment schedule, and restrictions that the debt instrument imposes on the entity).
- 11.43 For all financial assets and financial liabilities measured at fair value, the entity shall disclose the basis for determining fair value, eg quoted market price in an active market or a valuation technique. When a valuation technique is used, the entity shall disclose the assumptions applied in determining fair value for 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.
- 11.44 If a reliable measure of fair value is no longer available for an equity instrument measured at fair value through profit or loss, the entity shall disclose that fact.

Derecognition

- 11.45 If an entity has transferred financial assets to another party in a transaction that does not qualify for derecognition (see paragraphs 11.33–11.35), the entity shall disclose the following for each class of such financial assets:
- (a) the nature of the assets.
 - (b) the nature of the risks and rewards of ownership to which the entity remains exposed.
 - (c) the carrying amounts of the assets and of any associated liabilities that the entity continues to recognise.

Collateral

11.46 When an entity has pledged financial assets as collateral for liabilities or contingent liabilities, it shall disclose the following:

- (a) the carrying amount of the financial assets pledged as collateral.
- (b) the terms and conditions relating to its pledge.

Defaults and breaches on loans payable

11.47 For loans payable recognised at the reporting date for which there is a breach of terms or default of principal, interest, sinking fund, or redemption terms that has not been remedied by the reporting date, an entity shall disclose the following:

- (a) details of that breach or default.
- (b) the carrying amount of the related loans payable at the reporting date.
- (c) whether the breach or default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.

Items of income, expense, gains or losses

11.48 An entity shall disclose the following items of income, expense, gains or losses:

- (a) income, expense, gains or losses, including changes in fair value, recognised on:
 - (i) financial assets measured at fair value through profit or loss.
 - (ii) financial liabilities measured at fair value through profit or loss (with separate disclosure of movements on those which are not held as part of a trading portfolio and are not derivatives).
 - (iii) financial assets measured at amortised cost.
 - (iv) financial liabilities measured at amortised cost.
- (b) total interest income and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not measured at fair value through profit or loss.
- (c) the amount of any impairment loss for each class of financial asset.

Financial instruments at fair value

11.48A The following disclosures are required only for financial instruments at fair value that are, not held as part of a trading portfolio and are not derivatives:

- (a) the amount of change, during the period and cumulatively, in the fair value of the financial instrument that is attributable to changes in the credit risk of that instrument, 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 instrument.

- (b) the method used to establish the amount of change attributable to changes in own credit risk, or, if the change cannot be measured reliably or is not material, that fact.
- (c) 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.
- (d) if an instrument contains both a liability and an equity feature, and the instrument has multiple features that substantially modify the cash flows and the values of those features are interdependent (such as a callable convertible debt instrument), the existence of those features.
- (e) any difference between the fair value at initial recognition and the amount that would be determined at that date using a valuation technique, and the amount recognised in profit or loss.
- (f) information that enables users of the entity's financial statements to evaluate the nature and extent of relevant risks arising from financial instruments to which the entity is exposed at the end of the reporting period. These risks typically include, but are not limited to, credit risk, liquidity risk and market risk. The disclosure should include both the entity's exposure to each type of risk and how it manages those risks.

SECTION 12

OTHER FINANCIAL INSTRUMENTS ISSUES

Scope of Sections 11 and 12

12.1 Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues* together deal with recognising, derecognising, measuring, and disclosing **financial instruments** (**financial assets** and **financial liabilities**). Section 11 applies to basic financial instruments and is relevant to all entities. Section 12 applies to other, more complex financial instruments and transactions. If an entity enters into only basic financial instrument transactions then Section 12 is not applicable. However, even entities with only basic financial instruments shall consider the scope of Section 12 to ensure they are exempt.

PBE12.1 Public benefit entities that make or receive **concessionary loans** shall refer to the relevant paragraphs of Section 34 *Specialised Activities* for details on how to account for such loans.

Accounting policy choice

12.2 An entity shall choose to apply either:

- (a) the provisions of both Section 11 and Section 12 in full, or
- (b) the recognition and measurement provisions of IAS 39 *Financial Instruments: Recognition and Measurement*/IFRS 9 *Financial Instruments* (as adopted in the EU) and the disclosure requirements of Sections 11 and 12

to account for all of its financial instruments. An entity's choice of (a) or (b) is an accounting policy choice. Paragraphs 10.8–10.14 contain requirements for determining when a change in accounting policy is appropriate, how such a change should be accounted for, and what information should be disclosed about the change in accounting policy.

Scope of Section 12

12.3 Section 12 applies to all financial instruments except the following:

- (a) those covered by Section 11.
- (b) interests in subsidiaries (see Section 9 *Consolidated and Separate Financial Statements*), associates (see Section 14 *Investments in Associates*) and joint ventures (see Section 15 *Investments in Joint Ventures*).
- (c) employers' rights and obligations under employee benefit plans (see Section 28 *Employee Benefits*).
- (d) rights under insurance contracts unless the insurance contract could result in a loss to either party as a result of contractual terms that are unrelated to:
 - (i) changes in the insured risk;
 - (ii) changes in foreign exchange rates; or
 - (iii) a default by one of the counterparties.

- (e) financial instruments that meet the definition of an entity's own equity (see Section 22 *Equity* and Section 26 *Share-based Payment*).
 - (f) leases (see Section 20 *Leases*) unless the lease could result in a loss to the lessor or the lessee as a result of contractual terms that are unrelated to:
 - (i) changes in the price of the leased asset;
 - (ii) changes in foreign exchange rates; or
 - (iii) a default by one of the counterparties.
 - (g) contracts for contingent consideration in a business combination (see Section 19 *Business Combinations and Goodwill*). This exemption applies only to the acquirer.
 - (h) any forward contract between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction.
 - (i) financial instruments, contracts and obligations to which Section 26 *Share-based payment* applies, except for contracts within the scope of paragraph 12.5 of this FRS.
- 12.4 Most contracts to buy or sell a non-financial item such as a commodity, inventory, or property, plant and equipment are excluded from this section because they are not financial instruments. However, this section applies to all contracts that impose risks on the buyer or seller that are not typical of contracts to buy or sell tangible assets. For example, this section applies to contracts that could result in a loss to the buyer or seller as a result of contractual terms that are unrelated to changes in the price of the non-financial item, changes in foreign exchange rates, or a default by one of the counterparties.
- 12.5 In addition to the contracts described in paragraph 12.4, this section applies to contracts to buy or sell non-financial items if the contract can be settled net in cash or another financial instrument, or by exchanging financial instruments as if the contracts were financial instruments, with the following exception: 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 are not financial instruments for the purposes of this section.

Initial recognition of financial assets and liabilities

- 12.6 An entity shall recognise a financial asset or a financial liability only when the entity becomes a party to the contractual provisions of the instrument.

Initial measurement

- 12.7 When a financial asset or financial liability is recognised initially, an entity shall measure it at its fair value, which is normally the transaction price.

Subsequent measurement

- 12.8 At the end of each **reporting period**, an entity shall measure all financial instruments within the scope of Section 12 at fair value and recognise changes in fair value in profit or loss, except as follows: equity instruments that are not publicly traded and whose fair value cannot otherwise be measured reliably, and contracts linked to such instruments that, if exercised, will result in delivery of such instruments, shall be measured at cost less impairment.

- 12.8A For financial instruments in the scope of this section that are not held for trading and are not derivative instruments, an entity shall provide additional disclosures as set out in paragraph 11.48A.
- 12.9 If a reliable measure of fair value is no longer available for an equity instrument that is not publicly traded but is measured at fair value through profit or loss, its fair value at the last date the instrument was reliably measurable is treated as the cost of the instrument. The entity shall measure the instrument at this cost amount less impairment until a reliable measure of fair value becomes available.

Fair value

- 12.10 An entity shall apply the guidance on fair value in paragraphs 11.27–11.32 to fair value measurements in accordance with this section as well as for fair value measurements in accordance with Section 11.
- 12.11 The fair value of a financial liability that is due on demand is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.
- 12.12 An entity shall not include transaction costs in the initial measurement of financial assets and liabilities that will be measured subsequently at fair value through profit or loss. If payment for an asset is deferred or is financed at a rate of interest that is not a market rate, the entity shall initially measure the asset at the present value of the future payments discounted at a market rate of interest.

Impairment of financial instruments measured at cost or amortised cost

- 12.13 An entity shall apply the guidance on impairment of a financial instrument measured at cost in paragraphs 11.21–11.26 to financial instruments measured at cost less impairment in accordance with this section.

Derecognition of a financial asset or financial liability

- 12.14 An entity shall apply the derecognition requirements in paragraphs 11.33–11.38 to financial assets and financial liabilities to which this section applies.

Hedge accounting

- 12.15 If specified criteria are met, an entity may designate a hedging relationship between a **hedging instrument** and a **hedged item** in such a way as to qualify for hedge accounting. Hedge accounting permits the gain or loss on the hedging instrument and on the hedged item to be recognised in profit or loss at the same time.
- 12.16 To qualify for hedge accounting, an entity shall comply with all of the following conditions:
- (a) the entity designates and documents the hedging relationship so that the risk being hedged, the hedged item and the hedging instrument are clearly identified and the risk in the hedged item is the risk being hedged with the hedging instrument.
 - (b) the hedged risk is one of the risks specified in paragraph 12.17.
 - (c) the hedging instrument is as specified in paragraph 12.18.
 - (d) the entity expects the hedging instrument to be highly effective in offsetting the designated hedged risk. The **effectiveness of a hedge** is the degree to which changes in the fair value

or cash flows of the hedged item that are attributable to the hedged risk are offset by changes in the fair value or cash flows of the hedging instrument.

12.17 This [draft] FRS permits hedge accounting only for the following risks:

- (a) interest rate risk of a debt instrument measured at amortised cost.
- (b) foreign exchange or interest rate risk in a firm commitment or a **highly probable forecast transaction**.
- (c) price risk of a commodity that it holds or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity.
- (d) foreign exchange risk in a net investment in a foreign operation.

Foreign exchange risk of a debt instrument measured at amortised cost is not in the list above because hedge accounting would not have any significant effect on the financial statements. Basic accounts, notes and loans receivable and payable are normally measured at amortised cost (see paragraph 11.5(d)). This would include payables denominated in a foreign currency. Paragraph 30.10 requires any change in the carrying amount of the payable because of a change in the exchange rate to be recognised in profit or loss. Therefore, both the change in fair value of the hedging instrument (the cross-currency swap) and the change in the carrying amount of the payable relating to the change in the exchange rate would be recognised in profit or loss and should offset each other except to the extent of the difference between the spot rate (at which the liability is measured) and the forward rate (at which the swap is measured).

12.18 This [draft] FRS permits hedge accounting only if the hedging instrument has all of the following terms and conditions:

- (a) it is an interest rate swap, a foreign currency swap, a cross currency interest rate swap, a foreign currency forward exchange contract, a commodity forward exchange contract, or a hedge of a foreign exchange risk in a net investment in a foreign operation; a financial asset; or financial liability that is expected to be **highly effective** in offsetting a risk identified in paragraph 12.17 that is designated as the hedged risk.
- (b) it involves a party external to the reporting entity (ie external to the **group**, segment or individual entity being reported on).
- (c) its **notional amount** is equal to the designated amount of the principal or notional amount of the hedged item.
- (d) it has a specified maturity date not later than
 - (i) the maturity of the financial instrument being hedged,
 - (ii) the expected settlement of the commodity purchase or sale commitment, or
 - (iii) the later of the occurrence and settlement of the highly probable forecast foreign currency or commodity transaction being hedged.
- (e) it has no prepayment, early termination or extension features other than at fair value.

Hedge of fixed interest rate risk of a recognised financial instrument or commodity price risk of a commodity held

- 12.19 If the conditions in paragraph 12.16 are met and the hedged risk is the exposure to a fixed interest rate risk of a debt instrument measured at amortised cost or the commodity price risk of a commodity that it holds, the entity shall:
- (a) recognise the hedging instrument as an asset or liability and the change in the fair value of the hedging instrument in profit or loss, and
 - (b) recognise the change in the fair value of the hedged item related to the hedged risk in profit or loss and as an adjustment to the carrying amount of the hedged item.
- 12.20 If the hedged risk is the fixed interest rate risk of a debt instrument measured at amortised cost, the entity shall recognise the periodic net cash settlements on the interest rate swap that is the hedging instrument in profit or loss in the period in which the net settlements accrue.
- 12.21 The entity shall discontinue the hedge accounting specified in paragraph 12.19 if:
- (a) the hedging instrument expires or is sold or terminated;
 - (b) the hedge no longer meets the conditions for hedge accounting specified in paragraph 12.16; or
 - (c) the entity revokes the designation.
- 12.22 If hedge accounting is discontinued and the hedged item is an asset or liability carried at amortised cost that has not been derecognised, any gains or losses recognised as adjustments to the carrying amount of the hedged item are amortised into profit or loss using the effective interest method over the remaining life of the hedged instrument.

Hedge of variable interest rate risk of a recognised financial instrument, foreign exchange risk or commodity price risk in a firm commitment or highly probable forecast transaction, or a net investment in a foreign operation

- 12.23 If the conditions in paragraph 12.16 are met and the hedged risk is
- (a) the variable interest rate risk in a debt instrument measured at amortised cost,
 - (b) the foreign exchange risk in a **firm commitment** or a highly probable forecast transaction,
 - (c) the commodity price risk in a firm commitment or highly probable forecast transaction, or
 - (d) the foreign exchange risk in a net investment in a foreign operation,

the entity shall recognise in other comprehensive income the portion of the change in the fair value of the hedging instrument that was effective in offsetting the change in the fair value or expected cash flows of the hedged item. The entity shall recognise in profit or loss any excess of the fair value of the hedging instrument over the change in the fair value of the expected cash flows (sometimes called hedge ineffectiveness). The hedging gain or loss recognised in other comprehensive income shall be reclassified to profit or loss when the hedged item is recognised in profit or loss or when the hedging relationship ends. However, the cumulative amount of any exchange differences that relate to a hedge of a net investment in a foreign operation recognised in other comprehensive income shall not be reclassified to profit or loss on disposal or partial disposal of the foreign operation.

12.24 If the hedged risk is the variable interest rate risk in a debt instrument measured at amortised cost, the entity shall subsequently recognise in profit or loss the periodic net cash settlements from the interest rate swap that is the hedging instrument in the period in which the net settlements accrue.

12.25 The entity shall discontinue the hedge accounting specified in paragraph 12.23 if:

- (a) the hedging instrument expires or is sold or terminated;
- (b) the hedge no longer meets the criteria for hedge accounting in paragraph 12.16;
- (c) in a hedge of a forecast transaction, the forecast transaction is no longer highly probable; or
- (d) the entity revokes the designation.

If the forecast transaction is no longer expected to take place or if the hedged debt instrument measured at amortised cost is derecognised, any gain or loss on the hedging instrument that was recognised in other comprehensive income shall be reclassified from other comprehensive income to profit or loss.

Disclosures

12.26 An entity applying this section shall make all of the disclosures required in Section 11 incorporating in those disclosures financial instruments that are within the scope of this section as well as those within the scope of Section 11. In addition, if the entity uses hedge accounting, it shall make the additional disclosures in paragraphs 12.27–12.29.

12.27 An entity shall disclose the following separately for hedges of each of the four types of risks described in paragraph 12.17:

- (a) a description of the hedge.
- (b) a description of the financial instruments designated as hedging instruments and their fair values at the reporting date.
- (c) the nature of the risks being hedged, including a description of the hedged item.

12.28 If an entity uses hedge accounting for a hedge of fixed interest rate risk or commodity price risk of a commodity held (paragraphs 12.19–12.22) it shall disclose the following:

- (a) the amount of the change in fair value of the hedging instrument recognised in profit or loss.
- (b) the amount of the change in fair value of the hedged item recognised in profit or loss.

12.29 If an entity uses hedge accounting for a hedge of variable interest rate risk, foreign exchange risk, commodity price risk in a firm commitment or highly probable forecast transaction, or a net investment in a foreign operation (paragraphs 12.23–12.25) it shall disclose the following:

- (a) the periods when the cash flows are expected to occur and when they are expected to affect profit or loss.
- (b) a description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur.

- (c) the amount of the change in fair value of the hedging instrument that was recognised in other comprehensive income during the period (paragraph 12.23).
- (d) the amount that was reclassified from other comprehensive income to profit or loss for the period (paragraphs 12.23 and 12.25).
- (e) the amount of any excess of the fair value of the hedging instrument over the change in the fair value of the expected cash flows that was recognised in profit or loss (paragraph 12.24).

SECTION 13

INVENTORIES

Scope of this section

- 13.1 This section sets out the principles for recognising and measuring **inventories**. Inventories are **assets**:
- (a) held for sale in the ordinary course of business;
 - (b) in the process of production for such sale; or
 - (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.
- 13.2 This section applies to all inventories, except:
- (a) work in progress arising under construction contracts, including directly related service contracts (see Section 23 *Revenue*).
 - (b) financial instruments (see Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*).
 - (c) **biological assets** related to agricultural activity and **agricultural produce** at the point of harvest (see Section 34 *Specialised Activities*).
- 13.3 This section does not apply to the measurement of inventories held by:
- (a) producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at **fair value** less costs to sell through profit or loss, or
 - (b) commodity brokers and dealers that measure their inventories at fair value less costs to sell through profit or loss.

Measurement of inventories

- 13.4 An entity shall measure inventories at the lower of cost and estimated selling price less costs to complete and sell.
- 13.4A **Inventories held for distribution** shall be measured at **current replacement cost** adjusted, when applicable, for any loss of service potential.

Cost of inventories

- 13.5 An entity shall include in the cost of inventories all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.
- 13.5A Where inventories are acquired through a non-exchange transaction, their cost shall be measured at their fair value as at the date of acquisition. For public benefit entities, this requirement only applies to inventory that is recognised as a result of the incoming resources from non-exchange transactions as prescribed in Section 34 *Specialised Activities*.

Costs of purchase

- 13.6 The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.
- 13.7 An entity may purchase inventories on deferred settlement terms. In some cases, the arrangement effectively contains an unstated financing element, for example, a difference between the purchase price for normal credit terms and the deferred settlement amount. In these cases, the difference is recognised as interest expense over the period of the financing and is not added to the cost of the inventories.

Costs of conversion

- 13.8 The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

Allocation of production overheads

- 13.9 An entity shall allocate fixed production overheads to the costs of conversion on the basis of the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

Joint products and by-products

- 13.10 A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of raw materials or conversion of each product are not separately identifiable, an entity shall allocate them between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products, by their nature, are immaterial. When this is the case, the entity shall measure them at selling price less costs to complete and sell and deduct this amount from the cost of the main product. As a result, the **carrying amount** of the main product is not materially different from its cost.

Other costs included in inventories

- 13.11 An entity shall include other costs in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.
- 13.12 Paragraph 12.19(b) provides that, in some circumstances, the change in the fair value of the hedging instrument in a hedge of fixed interest rate risk or commodity price risk of a commodity held adjusts the carrying amount of the commodity.

Costs excluded from inventories

- 13.13 Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:
- (a) abnormal amounts of wasted materials, labour or other production costs.
 - (b) storage costs, unless those costs are necessary during the production process before a further production stage.
 - (c) administrative overheads that do not contribute to bringing inventories to their present location and condition.
 - (d) selling costs.

Cost of inventories of a service provider

- 13.14 To the extent that service providers have inventories, they measure them at the costs of their production. These costs consist primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel, and attributable overheads. Labour and other costs relating to sales and general administrative personnel are not included but are recognised as expenses in the period in which they are incurred. The cost of inventories of a service provider does not include profit margins or non-attributable overheads that are often factored into prices charged by service providers.

Cost of agricultural produce harvested from biological assets

- 13.15 Section 34 requires that inventories comprising agricultural produce that an entity has harvested from its biological assets should be measured on initial **recognition** at their fair value less estimated costs to sell at the point of harvest. This becomes the cost of the inventories at that date for application of this section.

Techniques for measuring cost, such as standard costing, retail method and most recent purchase price

- 13.16 An entity may use techniques such as the standard cost method, the retail method or most recent purchase price for measuring the cost of inventories if the result approximates cost. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions. The retail method measures cost by reducing the sales value of the inventory by the appropriate percentage gross margin.

Cost formulas

- 13.17 An entity shall measure the cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects by using specific identification of their individual costs.
- 13.18 An entity shall measure the cost of inventories, other than those dealt with in paragraph 13.17, by using the first-in, first-out (FIFO) or weighted average cost formula. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified. The last-in, first-out method (LIFO) is not permitted by this [draft] FRS.

Impairment of inventories

- 13.19 Paragraphs 27.2–27.4 require an entity to assess at the end of each **reporting period** whether any inventories are impaired, ie the carrying amount is not fully recoverable (eg because of damage, obsolescence or declining selling prices). If an item (or group of items) of inventory is impaired, those paragraphs require the entity to measure the inventory at its selling price less costs to complete and sell, and to recognise an **impairment loss**. Those paragraphs also require a reversal of a prior impairment in some circumstances.

Recognition as an expense

- 13.20 When inventories are sold, the entity shall recognise the carrying amount of those inventories as an expense in the period in which the related revenue is recognised.
- 13.20A When inventories held for distribution are distributed, the carrying amount of those inventories shall be recognised as an expense.
- 13.21 Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are accounted for subsequently in accordance with the section of this [draft] FRS relevant to that type of asset.

Disclosures

- 13.22 An entity shall disclose the following:
- (a) the **accounting policies** adopted in measuring inventories, including the cost formula used.
 - (b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity.
 - (c) the amount of inventories recognised as an expense during the period.
 - (d) impairment losses recognised or reversed in profit or loss in accordance with Section 27.
 - (e) the total carrying amount of inventories pledged as security for liabilities.

SECTION 14

INVESTMENTS IN ASSOCIATES

Scope of this section

- 14.1 This section applies to accounting for **associates** in **consolidated financial statements**. This section also applies to accounting for investments in associates in the financial statements of an investor that is not a parent. An entity that is a parent shall account for its investments in associates in its **separate financial statements** in accordance with paragraph 9.26 and 9.26A, as appropriate.

Associates defined

- 14.2 An associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a **subsidiary** nor an interest in a **joint venture**.
- 14.3 Significant influence is the power to participate in the financial and operating policy decisions of the associate but is not **control** or **joint control** over those policies.
- (a) If an investor holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power of the associate, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case.
 - (b) Conversely, if the investor holds, directly or indirectly (eg through subsidiaries), less than 20 per cent of the voting power of the associate, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.
 - (c) A substantial or majority ownership by another investor does not preclude an investor from having significant influence.

Measurement—accounting policy election

- 14.4 An investor which is not a parent but that has an investment in one or more associates shall account for all of its investments in associates using either:
- (a) the cost model in paragraph 14.5; or
 - (b) the **fair value** model in paragraph 14.9.
- 14.4A An investor which is a parent shall, in its consolidated financial statements, account for all of its investments in associates using the equity method in paragraph 14.8.
- 14.4B Associates that are held as part of an investment portfolio shall be measured at fair value with changes in fair value recognised in profit or loss. An associate is held as part of an investment portfolio if its value to the investor is through its fair value as part of a directly or indirectly held basket of investments rather than as media through which the investor carries out business. A basket of investments is indirectly held if an investment fund holds a single investment in a second investment fund which, in turn, holds a basket of investments.

Cost model

- 14.5 An investor which is not a parent shall measure its investments in associates at cost less any accumulated **impairment losses** recognised in accordance with Section 27 *Impairment of Assets*.
- 14.6 The investor shall recognise dividends and other distributions received from the investment as income without regard to whether the distributions are from accumulated profits of the associate arising before or after the date of acquisition.
- 14.7 [Not used]

Equity method

- 14.8 Under the equity method of accounting, an equity investment is initially recognised at the transaction price (including transaction costs) and is subsequently adjusted to reflect the investor's share of the **profit or loss** and other comprehensive income of the associate.
- (a) *Distributions and other adjustments to carrying amount.* Distributions received from the associate reduce the carrying amount of the investment. Adjustments to the carrying amount may also be required as a consequence of changes in the associate's equity arising from items of **other comprehensive income**.
 - (b) *Potential voting rights.* Although potential voting rights are considered in deciding whether significant influence exists, an investor shall measure its share of profit or loss of the associate and its share of changes in the associate's equity on the basis of present ownership interests. Those measurements shall not reflect the possible exercise or conversion of potential voting rights.
 - (c) *Implicit goodwill and fair value adjustments.* On acquisition of the investment in an associate, an investor shall account for any difference (whether positive or negative) between the cost of acquisition and the investor's share of the fair values of the net identifiable assets of the associate in accordance with paragraphs 19.22–19.24. An investor shall adjust its share of the associate's profits or losses after acquisition to account for additional depreciation or amortisation of the associate's depreciable or amortisable assets (including goodwill) on the basis of the excess of their fair values over their carrying amounts at the time the investment was acquired.
 - (d) *Impairment.* If there is an indication that an investment in an associate may be impaired, an investor shall test the entire carrying amount of the investment for impairment in accordance with Section 27 as a single asset. Any goodwill included as part of the carrying amount of the investment in the associate is not tested separately for impairment but, rather, as part of the test for impairment of the investment as a whole.
 - (e) *Investor's transactions with associates.* If an associate is accounted for using the equity method, the investor shall eliminate unrealised profits and losses resulting from upstream (associate to investor) and downstream (investor to associate) transactions to the extent of the investor's interest in the associate. Unrealised losses on such transactions may provide evidence of an impairment of the asset transferred.
 - (f) *Date of associate's financial statements.* In applying the equity method, the investor shall use the financial statements of the associate as of the same date as the financial statements of the investor unless it is **impracticable** to do so. If it is impracticable, the investor shall use the most recent available financial statements of the associate, with adjustments made for the effects of any significant transactions or events occurring between the accounting period ends.

- (g) *Associate's accounting policies.* If the associate uses accounting policies that differ from those of the investor, the investor shall adjust the associate's financial statements to reflect the investor's accounting policies for the purpose of applying the equity method unless it is impracticable to do so.
- (h) *Losses in excess of investment.* If an investor's share of losses of an associate equals or exceeds the carrying amount of its investment in the associate, the investor shall discontinue recognising its share of further losses. After the investor's interest is reduced to zero, the investor shall recognise additional losses by a provision (see Section 21 *Provisions and Contingencies*) only to the extent that the investor has incurred legal or constructive obligations or has made payments on behalf of the associate. If the associate subsequently reports profits, the investor shall resume recognising its share of those profits only after its share of the profits equals the share of losses not recognised.
- (i) *Discontinuing the equity method.* An investor shall cease using the equity method from the date that significant influence ceases.
 - (i) If the associate becomes a subsidiary or joint venture, the investor shall remeasure its previously held equity interest to fair value and recognise the resulting gain or loss, if any, in profit or loss.
 - (ii) If an investor loses significant influence over an associate as a result of a full or partial disposal, it shall derecognise that associate and recognise in profit or loss the difference between, on the one hand, the sum of the proceeds received plus the fair value of any retained interest and, on the other hand, the carrying amount of the investment in the associate at the date significant influence is lost. Thereafter, the investor shall account for any retained interest using Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*, as appropriate.
 - (iii) If an investor loses significant influence for reasons other than a partial disposal of its investment, the investor shall regard the carrying amount of the investment at that date as a new cost basis and shall account for the investment using Sections 11 and 12, as appropriate.

Fair value model

- 14.9 When an investment in an associate is recognised initially, an investor shall measure it at the transaction price. Transaction prices exclude transaction costs.
- 14.10 At each **reporting date**, an investor which is not a parent shall measure its investments in associates at fair value, with changes in fair value recognised in accordance with paragraphs 17.15E and 17.15F, using the fair value guidance in paragraphs 11.27–11.32. An investor using the fair value model shall use the cost model for any investment in an associate for which it is impracticable to measure fair value reliably without undue cost or effort.
- 14.10A The investor shall recognise dividends and other distributions received from the investment as income without regard to whether the distributions are from accumulated profits of the associate arising before or after the date of acquisition.

Financial statement presentation

- 14.11 An investor shall classify investments in associates as fixed assets.

Disclosures

- 14.12 An investor in an associate shall disclose the following:
- (a) its **accounting policy** for investments in associates.
 - (b) the **carrying amount** of investments in associates.
 - (c) the fair value of investments in associates accounted for using the equity method for which there are published price quotations.
- 14.13 For investments in associates accounted for by the cost model, an investor shall disclose the amount of dividends and other distributions recognised as income.
- 14.14 For investments in associates accounted for by the equity method, an investor shall disclose separately its share of the profit or loss of such associates and its share of any **discontinued operations** of such associates.
- 14.15 For investments in associates accounted for by the fair value model, an investor shall make the disclosures required by paragraphs 11.43 and 11.44.

SECTION 15

INVESTMENTS IN JOINT VENTURES

Scope of this section

- 15.1 This section applies to accounting for **joint ventures** in **consolidated financial statements** and in the financial statements of a venturer. However, a venturer that is a parent shall account for interests in **jointly controlled entities** in its **separate financial statements** in accordance with paragraph 9.26 and 9.26A, as appropriate.

Joint ventures defined

- 15.2 **Joint control** is the contractually agreed sharing of **control** over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).
- 15.3 A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures can take the form of jointly controlled operations, jointly controlled assets, or **jointly controlled entities**.

Jointly controlled operations

- 15.4 The operation of some joint ventures involves the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer uses its own property, plant and equipment and carries its own inventories. It also incurs its own expenses and liabilities and raises its own finance, which represent its own obligations. The joint venture activities may be carried out by the venturer's employees alongside the venturer's similar activities. The joint venture agreement usually provides a means by which the revenue from the sale of the joint product and any expenses incurred in common are shared among the venturers.
- 15.5 In respect of its interests in jointly controlled operations, a venturer shall recognise in its financial statements:
- (a) the assets that it controls and the liabilities that it incurs, and
 - (b) the expenses that it incurs and its share of the income that it earns from the sale of goods or services by the joint venture.

Jointly controlled assets

- 15.6 Some joint ventures involve the joint control, and often the joint ownership, by the venturers of one or more assets contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture.
- 15.7 In respect of its interest in a jointly controlled asset, a venturer shall recognise in its financial statements:
- (a) its share of the jointly controlled assets, classified according to the nature of the assets;
 - (b) any liabilities that it has incurred;

- (c) its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;
- (d) any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and
- (e) any expenses that it has incurred in respect of its interest in the joint venture.

Jointly controlled entities

- 15.8 A jointly controlled entity is a joint venture that involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other entities, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity.

Measurement—accounting policy election

- 15.9 A venturer which is not a parent but has one or more interests in jointly controlled entities shall account for all of its interests in jointly controlled entities using either:
- (a) the cost model in paragraph 15.10, or
 - (b) the **fair value** model in paragraph 15.14.
- 15.9A A venturer shall, in its consolidated financial statements, account for all of its investments in jointly controlled entities using the equity method in paragraph 15.13.
- 15.9B Jointly controlled entities held as part of an investment portfolio shall be measured at fair value with changes in fair value recognised in profit or loss. A jointly controlled entity is held as part of an investment portfolio if its value to the investor is through its fair value as part of a directly or indirectly held basket of investments rather than as media through which the investor carries out business. A basket of investments is indirectly held if an investment fund holds a single investment in a second investment fund which, in turn, holds a basket of investments.

Cost model

- 15.10 A venturer which is not a parent shall measure its investments in jointly controlled entities, at cost less any accumulated impairment losses recognised in accordance with Section 27 *Impairment of Assets*.
- 15.11 The venturer shall recognise distributions received from the investment as income without regard to whether the distributions are from accumulated profits of the jointly controlled entity arising before or after the date of acquisition.
- 15.12 [Not used]

Equity method

- 15.13 A venturer shall measure its investments in jointly controlled entities by the equity method using the procedures in paragraph 14.8 (substituting ‘joint control’ where that paragraph refers to ‘significant influence’).

Fair value model

- 15.14 At each **reporting date**, a venturer which is not a parent shall measure its investments in jointly controlled entities at fair value using the fair value guidance in paragraphs 11.27–11.32. Changes in fair value shall be recognised in accordance with paragraphs 17.15E and 17.15F. A venturer using the fair value model shall use the cost model for any investment in a jointly

controlled entity for which it is impracticable to measure fair value reliably without undue cost or effort.

- 15.15 The venturer shall recognise dividends and other distributions received from the investment as income without regard to whether the distributions are from accumulated profits of the associate arising before or after the date of acquisition.

Transactions between a venturer and a joint venture

- 15.16 When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer shall recognise only that portion of the gain or loss that is attributable to the interests of the other venturers. The venturer shall recognise the full amount of any loss when the contribution or sale provides evidence of an impairment loss.
- 15.17 When a venturer purchases assets from a joint venture, the venturer shall not recognise its share of the profits of the joint venture from the transaction until it resells the assets to an independent party. A venturer shall recognise its share of the losses resulting from these transactions in the same way as profits except that losses shall be recognised immediately when they represent an **impairment loss**.

If investor does not have joint control

- 15.18 An investor in a joint venture that does not have joint control shall account for that investment in accordance with Section 11 or, if it has significant influence in the joint venture, in accordance with Section 14 *Investments in Associates*.

Disclosures

- 15.19 An investor in a joint venture shall disclose:
- (a) the **accounting policy** it uses for recognising its interests in jointly controlled entities.
 - (b) the **carrying amount** of investments in jointly controlled entities.
 - (c) the fair value of investments in jointly controlled entities accounted for using the equity method for which there are published price quotations.
 - (d) the aggregate amount of its commitments relating to joint ventures, including its share in the capital commitments that have been incurred jointly with other venturers, as well as its share of the capital commitments of the joint ventures themselves.
- 15.20 For jointly controlled entities accounted for in accordance with the equity method, the venturer shall also make the disclosures required by paragraph 14.14 for equity method investments.
- 15.21 For jointly controlled entities accounted for in accordance with the fair value model, the venturer shall make the disclosures required by paragraphs 11.43 and 11.44.

SECTION 16

INVESTMENT PROPERTY

Scope of this section

- 16.1 This section applies to accounting for investments in land or buildings that meet the definition of **investment property** in paragraph 16.2 and some property interests held by a lessee under an operating lease (see paragraph 16.3) that are treated like investment property. Only investment property whose fair value can be measured reliably without undue cost or effort on an ongoing basis is accounted for in accordance with this section at fair value through profit or loss. All other investment property is accounted for as property, plant and equipment using the cost-depreciation-impairment model in Section 17 *Property, Plant and Equipment* and remains within the scope of Section 17 unless a reliable measure of fair value becomes available and it is expected that fair value will be reliably measurable on an ongoing basis.

Definition and initial recognition of investment property

- 16.2 Investment property is property (land or a building, or part of a building, or both) held by the owner or by the lessee under a **finance lease** to earn rentals or for capital appreciation or both, rather than for:
- (a) use in the production or supply of goods or services or for administrative purposes, or
 - (b) sale in the ordinary course of business.
- 16.3 A property interest that is held by a lessee under an **operating lease** may be classified and accounted for as investment property using this section if, and only if, the property would otherwise meet the definition of an investment property and the lessee can measure the fair value of the property interest without undue cost or effort on an ongoing basis. This classification alternative is available on a property-by-property basis.
- 16.3A Property held primarily for the provision of social benefits, eg social housing held by a public benefit entity, shall not be classified as investment property and shall be accounted for as property, plant and equipment in accordance with Section 17.
- 16.4 Mixed use property shall be separated between investment property and property, plant and equipment. However, if the fair value of the investment property component cannot be measured reliably without undue cost or effort, the entire property shall be accounted for as property, plant and equipment in accordance with Section 17.

Measurement at initial recognition

- 16.5 An entity shall measure investment property at its cost at initial recognition. The cost of a purchased investment property comprises its purchase price and any directly attributable expenditure such as legal and brokerage fees, property transfer taxes and other transaction costs. If payment is deferred beyond normal credit terms, the cost is the **present value** of all future payments. An entity shall determine the cost of a self-constructed investment property in accordance with paragraphs 17.10–17.14.
- 16.6 The initial cost of a property interest held under a lease and classified as an investment property shall be as prescribed for a finance lease by paragraph 20.9, even if the lease would otherwise be classified as an operating lease if it was in the scope of Section 20 *Leases*. In other words, the asset is recognised at the lower of the fair value of the property and the present value of the

minimum lease payments. An equivalent amount is recognised as a liability in accordance with paragraph 20.9.

Measurement after recognition

- 16.7 Investment property whose fair value can be measured reliably without undue cost or effort shall be measured at fair value at each **reporting date** with changes in fair value recognised in profit or loss. If a property interest held under a lease is classified as investment property, the item accounted for at fair value is that interest and not the underlying property. Paragraphs 11.27–11.32 provide guidance on determining fair value. An entity shall account for all other investment property as property, plant and equipment using the cost-depreciation-impairment model in Section 17.

Transfers

- 16.8 If a reliable measure of fair value is no longer available without undue cost or effort for an item of investment property measured using the fair value model, the entity shall thereafter account for that item as property, plant and equipment in accordance with Section 17 until a reliable measure of fair value becomes available. The carrying amount of the investment property on that date becomes its cost under Section 17. Paragraph 16.10(e)(iii) requires disclosure of this change. It is a change of circumstances and not a change in accounting policy.
- 16.9 Other than as required by paragraph 16.8, an entity shall transfer a property to, or from, investment property only when the property first meets, or ceases to meet, the definition of investment property.

Disclosures

- 16.10 An entity shall disclose the following for all investment property accounted for at fair value through profit or loss (paragraph 16.7):
- (a) the methods and significant assumptions applied in determining the fair value of investment property.
 - (b) the extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and class of the investment property being valued. If there has been no such valuation, that fact shall be disclosed.
 - (c) the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal.
 - (d) contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements.

- (e) a reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing separately:
 - (i) additions, disclosing separately those additions resulting from acquisitions through business combinations.
 - (ii) net gains or losses from fair value adjustments.
 - (iii) transfers to property, plant and equipment when a reliable measure of fair value is no longer available without undue cost or effort (see paragraph 16.8).
 - (iv) transfers to and from inventories and owner-occupied property.
 - (v) other changes.

This reconciliation need not be presented for prior periods.

- 16.11 In accordance with Section 20, the owner of an investment property provides lessors' disclosures about leases into which it has entered. An entity that holds an investment property under a finance lease or operating lease provides lessees' disclosures for finance leases and lessors' disclosures for any operating leases into which it has entered.

SECTION 17

PROPERTY, PLANT AND EQUIPMENT

Scope

- 17.1 This section applies to accounting for **property, plant and equipment** and **investment property** whose fair value cannot be measured reliably without undue cost or effort. Section 16 *Investment Property* applies to investment property whose fair value can be measured reliably without undue cost or effort.
- 17.2 Property, plant and equipment are tangible assets that:
- (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and
 - (b) are expected to be used during more than one period.
- 17.3 Property, plant and equipment does not include:
- (a) biological assets related to agricultural activity or heritage assets (see Section 34 *Specialised Activities*), or
 - (b) mineral rights and mineral reserves, such as oil, natural gas and similar non-regenerative resources.

Recognition

- 17.4 An entity shall apply the recognition criteria in paragraph 2.27 in determining whether to recognise an item of property, plant or equipment. Therefore, the entity shall recognise the cost of an item of property, plant and equipment as an asset if, and only if:
- (a) it is **probable** that future economic benefits associated with the item will flow to the entity, and
 - (b) the cost of the item can be measured reliably.
- 17.5 Spare parts and servicing equipment are usually carried as inventory and recognised in profit or loss as consumed. However, major spare parts and stand-by equipment are property, plant and equipment when an entity expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used only in connection with an item of property, plant and equipment, they are considered property, plant and equipment.
- 17.6 Parts of some items of property, plant and equipment may require replacement at regular intervals (eg the roof of a building). An entity shall add to the **carrying amount** of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the replacement part is expected to provide incremental future benefits to the entity. The carrying amount of those parts that are replaced is **derecognised** in accordance with paragraphs 17.27–17.30. Paragraph 17.16 provides that if the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and **depreciate** each such component separately over its **useful life**.
- 17.7 A condition of continuing to operate an item of property, plant and equipment (eg a bus) may be performing regular major inspections for faults regardless of whether parts of the item are

replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous major inspection (as distinct from physical parts) is derecognised. This is done regardless of whether the cost of the previous major inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

- 17.8 Land and buildings are separable assets, and an entity shall account for them separately, even when they are acquired together.

Measurement at recognition

- 17.9 An entity shall measure an item of property, plant and equipment at initial recognition at its cost.

Elements of cost

- 17.10 The cost of an item of property, plant and equipment comprises all of the following:
- (a) its purchase price, including legal and brokerage fees, import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
 - (b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. These can include the costs of site preparation, initial delivery and handling, installation and assembly, and testing of functionality.
 - (c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for 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.
 - (d) any borrowing costs capitalised in accordance with paragraph 25.2.
- 17.11 The following costs are not costs of an item of property, plant and equipment, and an entity shall recognise them as an expense when they are incurred:
- (a) costs of opening a new facility.
 - (b) costs of introducing a new product or service (including costs of advertising and promotional activities).
 - (c) costs of conducting business in a new location or with a new class of customer (including costs of staff training).
 - (d) administration and other general overhead costs.
- 17.12 The income and related expenses of incidental operations during construction or development of an item of property, plant and equipment are recognised in profit or loss if those operations are not necessary to bring the item to its intended location and operating condition.

Measurement of cost

- 17.13 The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the cost is the **present value** of all future payments.

Exchanges of assets

- 17.14 An item of property, plant or equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. An entity shall measure the cost of the acquired asset at **fair value** unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. In that case, the asset's cost is measured at the carrying amount of the asset given up.

Measurement after initial recognition

- 17.15 An entity shall measure all items of property, plant and equipment after initial recognition using the cost model or the revaluation model. Where the revaluation model is selected, this shall be applied to all items of property, plant and equipment in the same class (ie having a similar nature, function or use in the business). An entity shall recognise the costs of day-to-day servicing of an item of property, plant and equipment in profit or loss in the period in which the costs are incurred.

Cost model

- 17.15A After initial recognition under the cost model, an entity shall measure an item of property, plant and equipment at cost less any accumulated depreciation and any accumulated impairment losses.

Revaluation model

- 17.15B After recognition under the revaluation model, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.
- 17.15C The fair value of land and buildings is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers. The fair value of items of plant and equipment is usually their market value determined by appraisal.
- 17.15D If there is no market-based evidence of fair value because of the specialised nature of the item of property, plant and equipment and the item is rarely sold, except as part of a continuing business, an entity may need to estimate fair value using an income or a depreciated replacement cost approach.

Reporting gains and losses on revaluations

- 17.15E If an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation reserve. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.
- 17.15F If an asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance existing in the revaluation reserve in respect of that

asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation reserve.

Depreciation

- 17.16 If the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and depreciate each such component separately over its useful life. Other assets shall be depreciated over their useful lives as a single asset. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated.
- 17.17 The depreciation charge for each period shall be recognised in profit or loss unless another section of this [draft] FRS requires the cost to be recognised as part of the cost of an asset. For example, the depreciation of manufacturing property, plant and equipment is included in the costs of inventories (see Section 13 *Inventories*).

Depreciable amount and depreciation period

- 17.18 An entity shall allocate the **depreciable amount** of an asset on a systematic basis over its useful life.
- 17.19 Factors such as a change in how an asset is used, significant unexpected wear and tear, technological advancement, and changes in market prices may indicate that the residual value or useful life of an asset has changed since the most recent annual **reporting date**. If such indicators are present, an entity shall review its previous estimates and, if current expectations differ, amend the residual value, depreciation method or useful life. The entity shall account for the change in residual value, depreciation method or useful life as a change in an **accounting estimate** in accordance with paragraphs 10.15–10.18.
- 17.20 Depreciation of an asset begins when it is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases when the asset is derecognised. Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.
- 17.21 An entity shall consider all the following factors in determining the useful life of an asset:
- (a) the expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.
 - (b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.
 - (c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset.
 - (d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

Depreciation method

- 17.22 An entity shall select a depreciation method that reflects the pattern in which it expects to consume the asset's future economic benefits. The possible depreciation methods include the

straight-line method, the diminishing balance method and a method based on usage such as the units of production method.

- 17.23 If there is an indication that there has been a significant change since the last annual reporting date in the pattern by which an entity expects to consume an asset's future economic benefits, the entity shall review its present depreciation method and, if current expectations differ, change the depreciation method to reflect the new pattern. The entity shall account for the change as a change in an accounting estimate in accordance with paragraphs 10.15–10.18.

Impairment

Recognition and measurement of impairment

- 17.24 At each **reporting date**, an entity shall apply Section 27 *Impairment of Assets* to determine whether an item or group of items of property, plant and equipment is impaired and, if so, how to recognise and measure the impairment loss. That section explains when and how an entity reviews the carrying amount of its assets, how it determines the **recoverable amount** of an asset, and when it recognises or reverses an impairment loss.

Compensation for impairment

- 17.25 An entity shall include in profit or loss compensation from third parties for items of property, plant and equipment that were impaired, lost or given up only when the compensation is virtually certain.

Property, plant and equipment held for sale

- 17.26 Paragraph 27.9(f) states that a plan to dispose of an asset before the previously expected date is an indicator of impairment that triggers the calculation of the asset's recoverable amount for the purpose of determining whether the asset is impaired.

Derecognition

- 17.27 An entity shall derecognise an item of property, plant and equipment:

- (a) on disposal, or
- (b) when no future economic benefits are expected from its use or disposal.

- 17.28 An entity shall recognise the gain or loss on the derecognition of an item of property, plant and equipment in profit or loss when the item is derecognised (unless Section 20 *Leases* requires otherwise on a sale and leaseback). The entity shall not classify such gains as revenue.

- 17.29 In determining the date of disposal of an item, an entity shall apply the criteria in Section 23 *Revenue* for recognising revenue from the sale of goods. Section 20 applies to disposal by a sale and leaseback.

- 17.30 An entity shall determine the gain or loss arising from the derecognition of an item of property, plant and equipment as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

Disclosures

17.31 An entity shall disclose the following for each class of property, plant and equipment:

- (a) the measurement bases used for determining the gross carrying amount.
- (b) the depreciation methods used.
- (c) the useful lives or the depreciation rates used.
- (d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the reporting period.
- (e) a reconciliation of the carrying amount at the beginning and end of the reporting period showing separately:
 - (i) additions.
 - (ii) disposals.
 - (iii) acquisitions through **business combinations**.
 - (iv) revaluations.
 - (v) transfers to investment property if a reliable measure of fair value becomes available (see paragraph 16.8).
 - (vi) impairment losses recognised or reversed in profit or loss in accordance with Section 27.
 - (vii) depreciation.
 - (viii) other changes.

This reconciliation need not be presented for prior periods.

17.32 The entity shall also disclose the following:

- (a) the existence and carrying amounts of property, plant and equipment to which the entity has restricted title or that is pledged as security for liabilities.
- (b) the amount of contractual commitments for the acquisition of property, plant and equipment.

17.32A If items of property, plant and equipment are stated at revalued amounts, the following shall be disclosed:

- (a) the effective date of the revaluation;
- (b) whether an independent valuer was involved; and
- (c) the methods applied in estimating the items' fair values.

SECTION 18

INTANGIBLE ASSETS OTHER THAN GOODWILL

Scope of this section

- 18.1 This section applies to accounting for all **intangible assets** other than goodwill (see Section 19 *Business Combinations and Goodwill*) and intangible assets held by an entity for sale in the ordinary course of business (see Section 13 *Inventories* and Section 23 *Revenue*).
- 18.2 An intangible asset is an identifiable non-monetary asset without physical substance. Such an asset is identifiable when:
- (a) it is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability, or
 - (b) it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
- 18.3 Intangible assets do not include:
- (a) **financial assets**, or
 - (b) mineral rights and mineral reserves, such as oil, natural gas and similar non-regenerative resources.

Recognition

General principle for recognising intangible assets

- 18.4 An entity shall apply the recognition criteria in paragraph 2.27 in determining whether to recognise an intangible asset. Therefore, the entity shall recognise an intangible asset as an asset if, and only if:
- (a) it is **probable** that the expected future economic benefits that are attributable to the asset will flow to the entity; and
 - (b) the cost or value of the asset can be measured reliably.
- 18.5 An entity shall assess the probability of expected future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the economic conditions that will exist over the **useful life** of the asset.
- 18.6 An entity uses judgement to assess the degree of certainty attached to the flow of future economic benefits that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence.
- 18.7 The probability recognition criterion in paragraph 18.4(a) is always considered satisfied for intangible assets that are separately acquired.

Acquisition as part of a business combination

- 18.8 An intangible asset acquired in a **business combination** is normally recognised as an asset because its **fair value** can be measured with sufficient reliability. However, an intangible asset

acquired in a business combination is not recognised when it arises from legal or other contractual rights and its fair value cannot be measured reliably because the asset either

- (a) is not separable from **goodwill**, or
- (b) is separable from goodwill but there is no history or evidence of exchange transactions for the same or similar assets, and otherwise estimating fair value would be dependent on immeasurable variables.

Initial measurement

18.9 An entity shall measure an intangible asset initially at cost.

Separate acquisition

18.10 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.

18.10A The cost of an internally generated intangible asset for the purpose of paragraph 18.9 is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraph 18.4 and paragraph 18.16D.

18.10B 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 section 28) arising from the generation of the intangible asset;
- (c) fees to register a legal right; and
- (d) amortisation of patents and licences that are used to generate the intangible asset.

Section 25 specifies criteria for the recognition of interest as an element of the cost of an internally generated intangible asset.

Acquisition as part of a business combination

18.11 If an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date.

Acquisition by way of a grant

18.12 If an intangible asset is acquired by way of a grant, the cost of that intangible asset is its fair value at the date the grant is received or receivable in accordance with Section 24 *Grants*.

Exchanges of assets

18.13 An intangible asset may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. An entity shall measure the cost of such an intangible asset at fair value unless (a) the exchange transaction lacks commercial substance or

(b) the fair value of neither the asset received nor the asset given up is reliably measurable. In that case, the asset's cost is measured at the **carrying amount** of the asset given up.

Internally generated intangible assets

18.14 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.

18.14A 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.

18.15 An entity shall recognise expenditure on the following items as an expense and shall not recognise such expenditure as intangible assets:

- (a) internally generated brands, logos, publishing titles, customer lists and items similar in substance.
- (b) start-up activities (ie start-up costs), which include establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or business (ie pre-opening costs) and expenditure for starting new operations or launching new products or processes (ie pre-operating costs).
- (c) training activities.
- (d) advertising and promotional activities.
- (e) relocating or reorganising part or all of an entity.
- (f) internally generated goodwill.

18.16 Paragraph 18.15 does not preclude recognising a prepayment as an asset when payment for goods or services has been made in advance of the delivery of the goods or the rendering of the services.

Research phase

18.16A No intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred.

18.16B In the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits.

18.16C 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 and 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 material, devices, projects, processes, systems or services.

Development phase

18.16D An entity may recognise an intangible asset arising from development (or from the development phase of an internal project) 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. 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.
- (f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

18.16E 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. This is because the development phase of a project is further advanced than the research phase.

18.16F Examples of development activities are:

- (a) the design, construction and testing of pre-production or pre-use prototypes and models;
- (b) the design of tools, jigs, moulds and dies involving new technology;
- (c) the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and
- (d) the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

18.16G Where an entity adopts a policy of capitalising expenditure in the development phase that meet the conditions of paragraph 18.16D, that policy shall be applied consistently to all expenditure that meets the requirements of paragraph 18.16D. Expenditure that does not meet the conditions of paragraph 18.16D is expense as incurred.

Past expenses not to be recognised as an asset

18.17 Expenditure on an intangible item that was initially recognised as an expense shall not be recognised at a later date as part of the cost of an asset.

Measurement after recognition

- 18.18 An entity shall measure intangible assets after initial recognition using the cost model or the revaluation model. Where the revaluation model is selected, this shall be applied to all other intangible assets in the same class unless there is no **active market** for those intangible assets.

Cost model

- 18.18A After recognition under the cost model, an entity shall measure its assets at cost less any accumulated amortisation and any accumulated impairment losses. The requirements for amortisation are set out in this section. The requirements for recognition of impairment are set out in Section 27 *Impairment of Assets*.

Revaluation model

- 18.18B After recognition under the revaluation model, an intangible asset whose fair value can be measured reliably shall be carried at a revalued amount, being its **fair value** at the date of revaluation less any subsequent accumulated amortisation and subsequent accumulated impairment losses. The requirements for amortisation are set out in this section. The requirements for recognition of impairment are set out in Section 27.

- 18.18C The revaluation model does not allow:

- (a) the revaluation of intangible assets that have not previously been recognised as assets; or
- (b) the initial recognition of intangible assets at amounts other than cost.

- 18.18D For the purpose of revaluations under this FRS, fair value shall be determined by reference to an active market.

- 18.18E If the fair value of a revalued intangible asset can no longer be determined by reference to an active market in accordance with paragraph 18.18D, 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 amortisation and any subsequent accumulated impairment losses.

- 18.18F Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

- 18.18G The revaluation model is applied after an asset has been initially recognised at cost. However, if only part of the cost of an intangible asset is recognised as an asset because the asset did not meet the criteria for recognition until part of the way through the process (see paragraph 18.10A), the revaluation model may be applied to the whole of that asset.

Reporting gains and losses on revaluations

- 18.18H If an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation reserve. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

- 18.18I If an asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance existing in the revaluation reserve in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation reserve.

Amortisation over useful life

- 18.19 For the purpose of this [draft] FRS, all intangible assets shall be considered to have a finite useful life. The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset. If the contractual 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.
- 18.20 If an entity is unable to make a reliable estimate of the useful life of an intangible asset, the life shall be presumed to be five years.

Amortisation period and amortisation method

- 18.21 An entity shall allocate the **depreciable amount** of an intangible asset on a systematic basis over its useful life. The amortisation charge for each period shall be recognised as an expense, unless another section of this [draft] FRS requires the cost to be recognised as part of the cost of an asset such as inventories or property, plant and equipment.
- 18.22 Amortisation begins when the intangible asset is available for use, ie when it is in the location and condition necessary for it to be usable in the manner intended by management. Amortisation ceases when the asset is derecognised. The entity shall choose an amortisation method that reflects the pattern in which it expects to consume the asset's future economic benefits. If the entity cannot determine that pattern reliably, it shall use the straight-line method.

Residual value

- 18.23 An entity shall assume that the **residual value** of an intangible asset is zero unless:
- (a) there is a commitment by a third party to purchase the asset at the end of its useful life, or
 - (b) there is an active market for the asset and:
 - (i) residual value can be determined by reference to that market, and
 - (ii) it is probable that such a market will exist at the end of the asset's useful life.

Review of amortisation period and amortisation method

- 18.24 Factors such as a change in how an intangible asset is used, technological advancement, and changes in market prices may indicate that the residual value or useful life of an intangible asset has changed since the most recent annual **reporting date**. If such indicators are present, an entity shall review its previous estimates and, if current expectations differ, amend the residual value, amortisation method or useful life. The entity shall account for the change in residual value, amortisation method or useful life as a change in an **accounting estimate** in accordance with paragraphs 10.15–10.18.

Recoverability of the carrying amount—impairment losses

- 18.25 To determine whether an intangible asset is impaired, an entity shall apply Section 27. That section explains when and how an entity reviews the carrying amount of its assets, how it determines the **recoverable amount** of an asset, and when it recognises or reverses an impairment loss.

Retirements and disposals

18.26 An entity shall derecognise an intangible asset, and shall recognise a gain or loss in profit or loss:

- (a) on disposal, or
- (b) when no future economic benefits are expected from its use or disposal.

Disclosures

18.27 An entity shall disclose the following for each class of intangible assets:

- (a) the useful lives or the amortisation rates used and the reasons for choosing those periods.
- (b) the amortisation methods used.
- (c) the gross carrying amount and any accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the reporting period.
- (d) the line item(s) in the **statement of comprehensive income** (and in the **income statement**, if presented) in which any amortisation of intangible assets is included.
- (e) a reconciliation of the carrying amount at the beginning and end of the reporting period showing separately:
 - (i) additions, indicating separately those from internal development and those acquired separately.
 - (ii) disposals.
 - (iii) acquisitions through business combinations.
 - (iv) revaluations.
 - (v) amortisation.
 - (vi) impairment losses.
 - (vii) other changes.

This reconciliation need not be presented for prior periods.

18.28 An entity shall also disclose:

- (a) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is **material** to the entity's **financial statements**.
- (b) for intangible assets acquired by way of a grant and initially recognised at fair value (see paragraph 18.12):
 - (i) the fair value initially recognised for these assets, and
 - (ii) their carrying amounts.
- (c) the existence and carrying amounts of intangible assets to which the entity has restricted title or that are pledged as security for liabilities.
- (d) the amount of contractual commitments for the acquisition of intangible assets.

18.29 An entity shall disclose the aggregate amount of research and development expenditure recognised as an expense during the period (ie the amount of expenditure incurred internally on research and development that has not been capitalised as an intangible asset or as part of the cost of another asset that meets the recognition criteria in this [draft] FRS).

18.29A If intangible assets are accounted for at revalued amounts, an entity shall disclose the following:

- (a) the effective date of the revaluation;
- (b) whether an independent valuer was involved; and
- (c) the methods applied in estimating the assets' fair values.

SECTION 19

BUSINESS COMBINATIONS AND GOODWILL

Scope of this section

19.1 This section applies to accounting for **business combinations**. It provides guidance on identifying the acquirer, measuring the cost of the business combination, and allocating that cost to the assets acquired and liabilities and provisions for **contingent liabilities** assumed. It also addresses accounting for **goodwill** both at the time of a business combination and subsequently.

19.2 This section specifies the accounting for all business combinations except:

- (a) the formation of a **joint venture**.
- (b) acquisition of a group of assets that do not constitute a business.

PBE19.2A Section 34 *Specialised Activities* sets out the accounting for public benefit entity combinations.

Business combinations defined

19.3 A business combination is the bringing together of separate entities or businesses into one reporting entity. The result of nearly all business combinations is that one entity, the acquirer, obtains control of one or more other businesses, the acquiree. The acquisition date is the date on which the acquirer effectively obtains control of the acquiree.

19.4 A business combination may be structured in a variety of ways for legal, taxation or other reasons. It may involve the purchase by an entity of the equity of another entity, the purchase of all the net assets of another entity, the assumption of the liabilities of another entity, or the purchase of some of the net assets of another entity that together form one or more businesses.

19.5 A business combination may be effected by the issue of equity instruments, the transfer of cash, **cash equivalents** or other assets, or a mixture of these. The transaction may be between the shareholders of the combining entities or between one entity and the shareholders of another entity. It may involve the establishment of a new entity to control the combining entities or net assets transferred, or the restructuring of one or more of the combining entities.

Purchase method

19.6 All business combinations shall be accounted for by applying the purchase method, except for **combinations of entities or businesses under common control** which may be accounted for by using merger accounting method (see paragraphs 9.27 to 9.33).

19.7 Applying the purchase method involves the following steps:

- (a) identifying an acquirer.
- (b) measuring the cost of the business combination.
- (c) allocating, at the acquisition date, the cost of the business combination to the assets acquired and liabilities and provisions for **contingent liabilities** assumed.

Identifying the acquirer

- 19.8 An acquirer shall be identified for all business combinations. The acquirer is the combining entity that obtains control of the other combining entities or businesses.
- 19.9 Control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities. Control of one entity by another is described in Section 9 *Consolidated and Separate Financial Statements*.
- 19.10 Although it may sometimes be difficult to identify an acquirer, there are usually indications that one exists. For example:
- (a) if the **fair value** of one of the combining entities is significantly greater than that of the other combining entity, the entity with the greater fair value is likely to be the acquirer.
 - (b) if the business combination is effected through an exchange of voting ordinary equity instruments for cash or other assets, the entity giving up cash or other assets is likely to be the acquirer.
 - (c) if the business combination results in the management of one of the combining entities being able to dominate the selection of the management team of the resulting combined entity, the entity whose management is able so to dominate is likely to be the acquirer.

Cost of a business combination

- 19.11 The acquirer shall measure the cost of a business combination as the aggregate of:
- (a) the fair values, at **acquisition date**, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree, plus
 - (b) any costs directly attributable to the business combination.

Adjustments to the cost of a business combination contingent on future events

- 19.12 When a business combination agreement provides for an adjustment to the cost of the combination contingent on future events, the acquirer shall include the estimated amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is **probable** and can be measured reliably.
- 19.13 However, if the potential adjustment is not recognised at the acquisition date but subsequently becomes probable and can be measured reliably, the additional consideration shall be treated as an adjustment to the cost of the combination.

Allocating the cost of a business combination to the assets acquired and liabilities and contingent liabilities assumed

- 19.14 The acquirer shall, at the acquisition date, allocate the cost of a business combination by recognising the acquiree's identifiable assets and liabilities and a provision for those contingent liabilities that satisfy the recognition criteria in paragraph 19.20 at their fair values at that date. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities and provisions for contingent liabilities so recognised shall be accounted for in accordance with paragraphs 19.22–19.23 (as goodwill or so-called 'negative goodwill').
- 19.15 The acquirer shall recognise separately the acquiree's identifiable assets, liabilities and contingent liabilities at the acquisition date only if they satisfy the following criteria at that date:

- (a) In the case of an asset other than an intangible asset, it is probable that any associated future economic benefits will flow to the acquirer, and its fair value can be measured reliably.
 - (b) In the case of a liability other than a contingent liability, it is probable that an outflow of resources will be required to settle the obligation, and its fair value can be measured reliably.
 - (c) In the case of an intangible asset or a contingent liability, its fair value can be measured reliably.
- 19.16 The acquirer's statement of comprehensive income shall incorporate the acquiree's profits and losses after the acquisition date by including the acquiree's income and expenses based on the cost of the business combination to the acquirer. For example, depreciation expense included after the acquisition date in the acquirer's statement of comprehensive income that relates to the acquiree's depreciable assets shall be based on the fair values of those depreciable assets at the acquisition date, ie their cost to the acquirer.
- 19.17 Application of the purchase method starts from the acquisition date, which is the date on which the acquirer obtains control of the acquiree. Because control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities, it is not necessary for a transaction to be closed or finalised at law before the acquirer obtains control. All pertinent facts and circumstances surrounding a business combination shall be considered in assessing when the acquirer has obtained control.
- 19.18 In accordance with paragraph 19.14, the acquirer recognises separately only the identifiable assets, liabilities and contingent liabilities of the acquiree that existed at the acquisition date and satisfy the recognition criteria in paragraph 19.15. Therefore:
- (a) the acquirer shall recognise liabilities for terminating or reducing the activities of the acquiree as part of allocating the cost of the combination only when the acquiree has, at the acquisition date, an existing liability for restructuring recognised in accordance with Section 21 *Provisions and Contingencies*; and
 - (b) the acquirer, when allocating the cost of the combination, shall not recognise liabilities for future losses or other costs expected to be incurred as a result of the business combination.
- 19.19 If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall recognise in its financial statements provisional amounts for the items for which the accounting is incomplete. Within twelve months after the acquisition date, the acquirer shall retrospectively adjust the provisional amounts recognised as assets and liabilities at the acquisition date (ie account for them as if they were made at the acquisition date) to reflect new information obtained. Beyond twelve months after the acquisition date, adjustments to the initial accounting for a business combination shall be recognised only to correct an error in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

Contingent liabilities

- 19.20 Paragraph 19.14 specifies that the acquirer recognises separately a provision for a contingent liability of the acquiree only if its fair value can be measured reliably. If its fair value cannot be measured reliably:
- (a) there is a resulting effect on the amount recognised as goodwill or accounted for in accordance with paragraph 19.24; and
 - (b) the acquirer shall disclose the information about that contingent liability as required by Section 21.

19.21 After their initial recognition, the acquirer shall measure contingent liabilities that are recognised separately in accordance with paragraph 19.14 at the higher of:

- (a) the amount that would be recognised in accordance with Section 21, and
- (b) the amount initially recognised less amounts previously recognised as revenue in accordance with Section 23 *Revenue*.

Goodwill

19.22 The acquirer shall, at the acquisition date:

- (a) recognise goodwill acquired in a business combination as an asset, and
- (b) initially measure that goodwill at its cost, being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised in accordance with paragraph 19.14.

19.23 After initial recognition, the acquirer shall measure goodwill acquired in a business combination at cost less accumulated **amortisation** and accumulated **impairment** losses:

- (a) An entity shall follow the principles in paragraphs 18.19–18.24 for amortisation of goodwill. Goodwill shall be considered to have a finite useful life, and should be amortised on a systematic basis over its life. If an entity is unable to make a reliable estimate of the useful life of goodwill, the life shall be presumed to be five years.
- (b) An entity shall follow Section 27 *Impairment of Assets* for recognising and measuring the impairment of goodwill.

Excess over cost of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities

19.24 If the acquirer's interest in the net fair value of the identifiable assets, liabilities and provisions for contingent liabilities recognised in accordance with paragraph 19.14 exceeds the cost of the business combination (sometimes referred to as 'negative goodwill'), the acquirer shall:

- (a) reassess the identification and measurement of the acquiree's assets, liabilities and provisions for contingent liabilities and the measurement of the cost of the combination, and
- (b) recognise any excess which remains after the reassessment in profit or loss in the periods in which the non-monetary assets acquired are recovered.

Disclosures

For business combination(s) effected during the reporting period

19.25 For each business combination, excluding a combination of entities or a business combination under common control, that was effected during the period, the acquirer shall disclose the following:

- (a) the names and descriptions of the combining entities or businesses.
- (b) the acquisition date.
- (c) the percentage of voting equity instruments acquired.
- (d) the cost of the combination and a description of the components of that cost (such as cash, equity instruments and debt instruments).

- (e) the amounts recognised at the acquisition date for each class of the acquiree's assets, liabilities and contingent liabilities, including goodwill.
- (f) the amount of any excess recognised in profit or loss in accordance with paragraph 19.24, and the line item in the statement of comprehensive income (and in the income statement, if presented) in which the excess is recognised.
- (g) the useful life of goodwill, if this exceeds five years, and supporting reasons for this.

19.25A The acquirer shall disclose, either in aggregate or separately for each material business combination that occurs during the reporting period, the amounts of revenue and profit or loss of the acquiree since the acquisition date included in the consolidated statement of comprehensive income for the reporting period.

For all business combinations

- 19.26 An acquirer shall disclose a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period, showing separately:
- (a) changes arising from new business combinations.
 - (b) impairment losses.
 - (c) disposals of previously acquired businesses.
 - (d) other changes.

This reconciliation need not be presented for prior periods.

Combination of entities or business combination under common control

- 19.27 A combination of entities or business combination under common control may be accounted for by using the merger accounting method provided:
- (a) The use of the merger accounting method is not prohibited by company law or other relevant legislation;
 - (b) The ultimate equity holders remain the same, and the rights of each equity holder, relative to the others, are unchanged; and
 - (c) No non-controlling interest in the net assets of the group is altered by the transfer.

Applicability to various structures of business combinations

- 19.28 The provisions of paragraphs 19.29–19.33, which are explained by reference to an acquirer or issuing entity that issues shares as consideration for the transfer of its shares in the other parties to the combination, should also be read so as to apply to other arrangements that achieve similar results.

Merger accounting method

- 19.29 With the merger accounting method the carrying values of the assets and liabilities of the parties to the combination are not required to be adjusted to fair value, although appropriate adjustments should be made to achieve uniformity of accounting policies in the combining entities.

- 19.30 The results and cash flows of all the combining entities should be brought into the financial statements of the combined entity from the beginning of the financial year in which the combination occurred, adjusted so as to achieve uniformity of accounting policies. The comparative information corresponding figures should be restated by including the results for all the combining entities for the previous period and their balance sheet for the previous balance sheet date, adjusted as necessary to achieve uniformity of accounting policies.
- 19.31 The difference, if any, between the nominal value of the shares issued plus the fair value of any other consideration given, and the nominal value of the shares received in exchange should be shown as a movement on other reserves in the consolidated financial statements. Any existing balances on the share premium account or capital redemption reserve of the new subsidiary should be brought in by being shown as a movement on other reserves. These movements should be shown in the statement of changes in equity.
- 19.32 Merger expenses are not to be included as part of this adjustment, but should be charged to the statement of comprehensive income as part of profit or loss of the combined entity at the effective date of the combination of entities or business combination under common control.

Disclosures

- 19.33 For each combination of entities or business combination under common control, that was affected during the period, the combined entity shall disclose the following:
- (a) The names of the combining entities (other than the reporting entity);
 - (b) Whether the combination has been accounted for as an acquisition or a merger;
 - (c) The date of the combination.

SECTION 20

LEASES

Scope of this section

20.1 This section covers accounting for all **leases** other than:

- (a) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (see Section 34 *Specialised Activities*).
- (b) licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights (see Section 18 *Intangible Assets other than Goodwill*).
- (c) measurement of property held by lessees that is accounted for as **investment property** and measurement of investment property provided by lessors under operating leases (see Section 16 *Investment Property*).
- (d) measurement of **biological assets** held by lessees under finance leases and biological assets provided by lessors under operating leases (see Section 34).
- (e) leases that could lead to a loss to the lessor or the lessee as a result of contractual terms that are unrelated to changes in the price of the leased asset, changes in foreign exchange rates, or a default by one of the counterparties (see paragraph 12.3(f)).
- (f) operating leases that are onerous.

20.2 This section applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. This section does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

20.3 Some arrangements, such as outsourcing arrangements, telecommunication contracts that provide rights to capacity, and take-or-pay contracts, do not take the legal form of a lease but convey rights to use assets in return for payments. Such arrangements are in substance leases of assets, and they should be accounted for under this section.

Classification of leases

20.4 A lease is classified as a **finance lease** if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an **operating lease** if it does not transfer substantially all the risks and rewards incidental to ownership.

20.5 Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

- (a) the lease transfers ownership of the asset to the lessee by the end of the lease term.
- (b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the **fair value** at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised.
- (c) the lease term is for the major part of the economic life of the asset even if title is not transferred.

- (d) at the inception of the lease the **present value** of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.
 - (e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications.
- 20.6 Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:
- (a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee.
 - (b) gains or losses from the fluctuation in the **residual value** of the leased asset accrue to the lessee (eg in the form of a rent rebate equalling most of the sales proceeds at the end of the lease).
 - (c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.
- 20.7 The examples and indicators in paragraphs 20.5 and 20.6 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all risks and rewards incidental to ownership, the lease is classified as an operating lease. For example, this may be the case if ownership of the asset is transferred to the lessee at the end of the lease for a variable payment equal to the asset's then fair value, or if there are contingent rents, as a result of which the lessee does not have substantially all risks and rewards incidental to ownership.
- 20.8 Lease classification is made at the inception of the lease and is not changed during the term of the lease unless the lessee and the lessor agree to change the provisions of the lease (other than simply by renewing the lease), in which case the lease classification shall be re-evaluated.

Financial statements of lessees—finance leases

Initial recognition

- 20.9 At the commencement of the lease term, a lessee shall recognise its rights of use and obligations under finance leases as assets and liabilities in its statement of financial position at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, determined at the inception of the lease. Any initial direct costs of the lessee (incremental costs that are directly attributable to negotiating and arranging a lease) are added to the amount recognised as an asset.
- 20.10 The present value of the minimum lease payments should be calculated using the **interest rate implicit in the lease**. If this cannot be determined, the **lessee's incremental borrowing rate** shall be used.

Subsequent measurement

- 20.11 A lessee shall apportion minimum lease payments between the finance charge and the reduction of the outstanding liability using the **effective interest method** (see paragraphs 11.15–11.20). The lessee shall allocate the finance charge to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. A lessee shall charge contingent rents as expenses in the periods in which they are incurred.

- 20.12 A lessee shall depreciate an asset leased under a finance lease in accordance with the relevant section of this [draft] FRS for that type of asset, eg Section 17 *Property, Plant and Equipment*, Section 18 or Section 19 *Business Combinations and Goodwill*. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its useful life. A lessee shall also assess at each **reporting date** whether an asset leased under a finance lease is impaired (see Section 27 *Impairment of Assets*).

Disclosures

- 20.13 A lessee shall make the following disclosures for finance leases:
- (a) for each **class of asset**, the net **carrying amount** at the end of the **reporting period**.
 - (b) the total of future minimum lease payments at the end of the reporting period, for each of the following periods:
 - (i) not later than one year;
 - (ii) later than one year and not later than five years; and
 - (iii) later than five years.
 - (c) a general description of the lessee's significant leasing arrangements including, for example, information about contingent rent, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements.
- 20.14 In addition, the requirements for disclosure about assets in accordance with Sections 17, 18, 27 and 34 apply to lessees for assets leased under finance leases.

Financial statements of lessees—operating leases

Recognition and measurement

- 20.15 A lessee shall recognise lease payments under operating leases (excluding costs for services such as insurance and maintenance) as an expense on a straight-line basis unless either
- (a) another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis, or
 - (b) the payments to the lessor are structured to increase in line with expected general inflation (based on published indexes or statistics) to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary because of factors other than general inflation, then this condition (b) is not met.

Example of applying paragraph 20.15(b):

X operates in a jurisdiction in which the consensus forecast by local banks is that the general price level index, as published by the government, will increase by an average of 10 per cent annually over the next five years. X leases some office space from Y for five years under an operating lease. The lease payments are structured to reflect the expected 10 per cent annual general inflation over the five-year term of the lease as follows

Year 1	CU100,000
Year 2	CU110,000
Year 3	CU121,000
Year 4	CU133,000
Year 5	CU146,000

X recognises annual rent expense equal to the amounts owed to the lessor as shown above. If the escalating payments are not clearly structured to compensate the lessor for expected inflationary cost increases based on published indexes or statistics, then X recognises annual rent expense on a straight-line basis: CU122,000 each year (sum of the amounts payable under the lease divided by five years).

Disclosures

20.16 A lessee shall make the following disclosures for operating leases:

- (a) the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:
 - (i) not later than one year;
 - (ii) later than one year and not later than five years; and
 - (iii) later than five years.
- (b) lease payments recognised as an expense.

Financial statements of lessors: finance leases**Initial recognition and measurement**

- 20.17 A lessor shall recognise assets held under a finance lease in their statements of financial position and present them as a receivable at an amount equal to the **net investment in the lease**. The net investment in a lease is the lessor's **gross investment in the lease** discounted at the interest rate implicit in the lease. The gross investment in the lease is the aggregate of:
- (a) the minimum lease payments receivable by the lessor under a finance lease, and
 - (b) any unguaranteed residual value accruing to the lessor.
- 20.18 For finance leases other than those involving manufacturer or dealer lessors, initial direct costs (costs that are incremental and directly attributable to negotiating and arranging a lease) are included in the initial measurement of the finance lease receivable and reduce the amount of income recognised over the lease term.

Subsequent measurement

- 20.19 The recognition of finance income shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease. Lease payments relating to the period, excluding costs for services, are applied against the gross investment in the lease to reduce both the principal and the unearned finance income. If there is an indication that the estimated unguaranteed residual value used in computing the lessor's gross investment in the lease has changed significantly, the income allocation over the lease term is revised, and any reduction in respect of amounts accrued is recognised immediately in profit or loss.

Manufacturer or dealer lessors

- 20.20 Manufacturers or dealers often offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or dealer lessor gives rise to two types of income:
- (a) profit or loss equivalent to the profit or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts, and
 - (b) finance income over the lease term.
- 20.21 The sales revenue recognised at the commencement of the lease term by a manufacturer or dealer lessor is the fair value of the asset or, if lower, the present value of the minimum lease payments accruing to the lessor, computed at a market rate of interest. The cost of sale recognised at the commencement of the lease term is the cost, or carrying amount if different, of the leased property less the present value of the unguaranteed residual value. The difference between the sales revenue and the cost of sale is the selling profit, which is recognised in accordance with the entity's policy for outright sales.
- 20.22 If artificially low rates of interest are quoted, selling profit shall be restricted to that which would apply if a market rate of interest were charged. Costs incurred by manufacturer or dealer lessors in connection with negotiating and arranging a lease shall be recognised as an expense when the selling profit is recognised.

Disclosures

- 20.23 A lessor shall make the following disclosures for finance leases:
- (a) a reconciliation between the gross investment in the lease at the end of the reporting period, and the present value of minimum lease payments receivable at the end of the reporting period. In addition, a lessor shall disclose the gross investment in the lease and the present value of minimum lease payments receivable at the end of the reporting period, for each of the following periods:
 - (i) not later than one year;
 - (ii) later than one year and not later than five years; and
 - (iii) later than five years.
 - (b) unearned finance income.
 - (c) the unguaranteed residual values accruing to the benefit of the lessor.
 - (d) the accumulated allowance for uncollectible minimum lease payments receivable.
 - (e) contingent rents recognised as income in the period.

- (f) a general description of the lessor's significant leasing arrangements, including, for example, information about contingent rent, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements.

Financial statements of lessors: operating leases

Recognition and measurement

- 20.24 A lessor shall present assets subject to operating leases in its statement of financial position according to the nature of the asset.
- 20.25 A lessor shall recognise lease income from operating leases (excluding amounts for services such as insurance and maintenance) in profit or loss on a straight-line basis over the lease term, unless either
 - (a) another systematic basis is representative of the time pattern of the lessee's benefit from the leased asset, even if the receipt of payments is not on that basis, or
 - (b) the payments to the lessor are structured to increase in line with expected general inflation (based on published indexes or statistics) to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary according to factors other than inflation, then condition (b) is not met.
- 20.26 A lessor shall recognise as an expense costs, including depreciation, incurred in earning the lease income. The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets.
- 20.27 A lessor shall add to the carrying amount of the leased asset any initial direct costs it incurs in negotiating and arranging an operating lease and shall recognise such costs as an expense over the lease term on the same basis as the lease income.
- 20.28 To determine whether a leased asset has become impaired, a lessor shall apply Section 27.
- 20.29 A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.

Disclosures

- 20.30 A lessor shall disclose the following for operating leases:
 - (a) the future minimum lease payments under non-cancellable operating leases for each of the following periods:
 - (i) not later than one year; and
 - (ii) later than one year and not later than five years; and
 - (iii) later than five years.
 - (b) total contingent rents recognised as income.
 - (c) a general description of the lessor's significant leasing arrangements, including, for example, information about contingent rent, renewal or purchase options and escalation clauses, and restrictions imposed by lease arrangements.
- 20.31 In addition, the requirements for disclosure about assets in accordance with Sections 17, 18, 27 and 34 apply to lessors for assets provided under operating leases.

Sale and leaseback transactions

- 20.32 A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The lease payment and the sale price are usually interdependent because they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends on the type of lease.

Sale and leaseback transaction results in a finance lease

- 20.33 If a sale and leaseback transaction results in a finance lease, the seller-lessee shall not recognise immediately, as income, any excess of sales proceeds over the carrying amount. Instead, the seller-lessee shall defer such excess and amortise it over the lease term.

Sale and leaseback transaction results in an operating lease

- 20.34 If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, the seller-lessee shall recognise any profit or loss immediately. If the sale price is below fair value, the seller-lessee shall recognise any profit or loss immediately unless the loss is compensated for by future lease payments at below market price. In that case the seller-lessee shall defer and amortise such loss in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the seller-lessee shall defer the excess over fair value and amortise it over the period for which the asset is expected to be used.

Disclosures

- 20.35 Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of significant leasing arrangements includes description of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.

SECTION 21

PROVISIONS AND CONTINGENCIES

Scope of this section

- 21.1 This section applies to all **provisions** (ie liabilities of uncertain timing or amount), **contingent liabilities** and **contingent assets** except those provisions covered by other sections of this [draft] FRS. These include provisions relating to:
- (a) leases (Section 20 *Leases*). However, this section deals with operating leases that have become onerous.
 - (b) construction contracts (Section 23 *Revenue*).
 - (c) employee benefit obligations (Section 28 *Employee Benefits*).
 - (d) income tax (Section 29 *Income Tax*).
- 21.2 The requirements in this section do not apply to executory contracts unless they are **onerous contracts**. Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.
- 21.3 The word ‘provision’ is sometimes used in the context of such items as depreciation, impairment of assets, and uncollectible receivables. Those are adjustments of the **carrying amounts** of assets, rather than recognition of liabilities, and therefore are not covered by this section.

Initial recognition

- 21.4 An entity shall recognise a provision only when:
- (a) the entity has an obligation at the **reporting date** as a result of a past event;
 - (b) it is **probable** (ie more likely than not) that the entity will be required to transfer economic benefits in settlement; and
 - (c) the amount of the obligation can be estimated reliably.
- 21.5 The entity shall recognise the provision as a liability in the statement of financial position and shall recognise the amount of the provision as an expense, unless another section of this [draft] FRS requires the cost to be recognised as part of the cost of an asset such as inventories or property, plant and equipment.
- 21.6 The condition in paragraph 21.4(a) (obligation at the reporting date as a result of a past event) means that the entity has no realistic alternative to settling the obligation. This can happen when the entity has a legal obligation that can be enforced by law or when the entity has a **constructive obligation** because the past event (which may be an action of the entity) has created valid expectations in other parties that the entity will discharge the obligation. Obligations that will arise from the entity’s future actions (ie the future conduct of its business) do not satisfy the condition in paragraph 21.4(a), no matter how likely they are to occur and even if they are contractual. To illustrate, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a particular type of factory). Because the entity can avoid the future expenditure by its future actions, for example by

changing its method of operation or selling the factory, it has no present obligation for that future expenditure and no provision is recognised.

Initial measurement

- 21.7 An entity shall measure a provision at the best estimate of the amount required to settle the obligation at the reporting date. The best estimate is the amount an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time.
- (a) When the provision involves a large population of items, the estimate of the amount reflects the weighting of all possible outcomes by their associated probabilities. The provision will therefore be different depending on whether the probability of a loss of a given amount is, for example, 60 per cent or 90 per cent. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.
 - (b) When the provision arises from a single obligation, the individual most likely outcome may be the best estimate of the amount required to settle the obligation. However, even in such a case, the entity considers other possible outcomes. When other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount.

When the effect of the time value of money is **material**, the amount of a provision shall be the **present value** of the amount expected to be required to settle the obligation. The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money. The risks specific to the liability should be reflected either in the discount rate or in the estimation of the amounts required to settle the obligation, but not both.

- 21.8 An entity shall exclude gains from the expected disposal of assets from the measurement of a provision.
- 21.9 When some or all of the amount required to settle a provision may be reimbursed by another party (eg through an insurance claim), the entity shall recognise the reimbursement as a separate asset only when it is virtually certain that the entity will receive the reimbursement on settlement of the obligation. The amount recognised for the reimbursement shall not exceed the amount of the provision. The reimbursement receivable shall be presented in the statement of financial position as an asset and shall not be offset against the provision. In the statement of comprehensive income (or in the income statement, if presented) the expense relating to a provision may be presented net of the amount recognised for a reimbursement.

Subsequent measurement

- 21.10 An entity shall charge against a provision only those expenditures for which the provision was originally recognised.
- 21.11 An entity shall review provisions at each reporting date and adjust them to reflect the current best estimate of the amount that would be required to settle the obligation at that reporting date. Any adjustments to the amounts previously recognised shall be recognised in profit or loss unless the provision was originally recognised as part of the cost of an asset (see paragraph 21.5). When a provision is measured at the present value of the amount expected to be required to settle the obligation, the unwinding of the discount shall be recognised as a finance cost in profit or loss in the period it arises.

Contingent liabilities

- 21.12 A **contingent liability** is either a possible but uncertain obligation or a present obligation that is not recognised because it fails to meet one or both of the conditions (b) and (c) in paragraph 21.4. An entity shall not recognise a contingent liability as a liability, except for provisions for contingent liabilities of an acquiree in a business combination (see paragraphs 19.20 and 19.21). Disclosure of a contingent liability is required by paragraph 21.15 unless the possibility of an outflow of resources is remote. When an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability.

Contingent assets

- 21.13 An entity shall not recognise a **contingent asset** as an asset. Disclosure of a contingent asset is required by paragraph 21.16 when an inflow of economic benefits is probable. However, when the flow of future economic benefits to the entity is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate.

Disclosures

Disclosures about provisions

- 21.14 For each class of provision, an entity shall disclose all of the following:
- (a) a reconciliation showing
 - (i) the carrying amount at the beginning and end of the period;
 - (ii) additions during the period, including adjustments that result from changes in measuring the discounted amount;
 - (iii) amounts charged against the provision during the period; and
 - (iv) unused amounts reversed during the period.
 - (b) a brief description of the nature of the obligation and the expected amount and timing of any resulting payments.
 - (c) an indication of the uncertainties about the amount or timing of those outflows.
 - (d) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Comparative information for prior periods is not required.

Disclosures about contingent liabilities

- 21.15 Unless the possibility of any outflow of resources in settlement is remote, an entity shall disclose, for each class of contingent liability at the reporting date, a brief description of the nature of the contingent liability and, when practicable:
- (a) an estimate of its financial effect, measured in accordance with paragraphs 21.7–21.11;
 - (b) an indication of the uncertainties relating to the amount or timing of any outflow; and
 - (c) the possibility of any reimbursement.

If it is **impracticable** to make one or more of these disclosures, that fact shall be stated.

Disclosures about contingent assets

- 21.16 If an inflow of economic benefits is probable (more likely than not) but not virtually certain, an entity shall disclose a description of the nature of the contingent assets at the end of the **reporting period**, and, when practicable without undue cost or effort, an estimate of their financial effect, measured using the principles set out in paragraphs 21.7–21.11. If it is impracticable to make this disclosure, that fact shall be stated.

Prejudicial disclosures

- 21.17 In extremely rare cases, disclosure of some or all of the information required by paragraphs 21.14–21.16 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

APPENDIX TO SECTION 21

GUIDANCE ON RECOGNISING AND MEASURING PROVISIONS

This Appendix accompanies, but is not part of, Section 21. It provides guidance for applying the requirements of Section 21 in recognising and measuring provisions.

All of the entities in the examples in this Appendix have 31 December as their reporting date. In all cases, it is assumed that a reliable estimate can be made of any outflows expected. In some examples the circumstances described may have resulted in impairment of the assets; this aspect is not dealt with in the examples. References to 'best estimate' are to the present value amount, when the effect of the time value of money is material.

Example 1 Future operating losses

- 21A.1 An entity determines that it is probable that a segment of its operations will incur future operating losses for several years.

Present obligation as a result of a past obligating event—There is no past event that obliges the entity to pay out resources.

Conclusion—The entity does not recognise a provision for future operating losses. Expected future losses do not meet the definition of a liability. The expectation of future operating losses may be an indicator that one or more assets are impaired—see Section 27 *Impairment of Assets*.

Example 2 Onerous contracts

- 21A.2 An onerous contract is one in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. For example, an entity may be contractually required under an operating lease to make payments to lease an asset for which it no longer has any use.

Present obligation as a result of a past obligating event—The entity is contractually required to pay out resources for which it will not receive commensurate benefits.

Conclusion—If an entity has a contract that is onerous, the entity recognises and measures the present obligation under the contract as a provision.

Example 3 Restructurings

- 21A.3 A restructuring is a programme that is planned and controlled by management and materially changes either the scope of a business undertaken by an entity or the manner in which that business is conducted.

Present obligation as a result of a past obligating event—A constructive obligation to restructure arises only when an entity:

- (a) has a detailed formal plan for the restructuring identifying at least:
 - (i) the business or part of a business concerned;
 - (ii) the principal locations affected;

- (iii) the location, function and approximate number of employees who will be compensated for terminating their services;
 - (iv) the expenditures that will be undertaken; and
 - (v) when the plan will be implemented; and
- (b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

Conclusion—An entity recognises a provision for restructuring costs only when it has a legal or constructive obligation at the reporting date to carry out the restructuring.

Example 4 Warranties

- 21A.4 A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On the basis of experience, it is probable (ie more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event—The obligating event is the sale of the product with a warranty, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement—Probable for the warranties as a whole.

Conclusion—The entity recognises a provision for the best estimate of the costs of making good under the warranty products sold before the reporting date.

Illustration of calculations:

In 20X0, goods are sold for CU1,000,000. Experience indicates that 90 per cent of products sold require no warranty repairs; 6 per cent of products sold require minor repairs costing 30 per cent of the sale price; and 4 per cent of products sold require major repairs or replacement costing 70 per cent of sale price. Therefore estimated warranty costs are:

CU1,000,000 × 90% × 0 =	CU0
CU1,000,000 × 6% × 30% =	CU18,000
CU1,000,000 × 4% × 70% =	CU28,000
Total	CU46,000

The expenditures for warranty repairs and replacements for products sold in 20X0 are expected to be made 60 per cent in 20X1, 30 per cent in 20X2, and 10 per cent in 20X3, in each case at the end of the period. Because the estimated cash flows already reflect the probabilities of the cash outflows, and assuming there are no other risks or uncertainties that must be reflected, to determine the present value of those cash flows the entity uses a 'risk-free' discount rate based on government bonds with the same term as the expected cash outflows (6 per cent for one-year bonds and 7 per cent for two-year and three-year bonds). Calculation of the present value, at the end of 20X0, of the estimated cash flows related to the warranties for products sold in 20X0 is as follows:

Year		Expected cash payments (CU)	Discount rate	Discount factor	Present value (CU)
1	60% × CU46,000	27,600	6%	0.9434 (at 6% for 1 year)	26,038
2	30% × CU46,000	13,800	7%	0.8734 (at 7% for 2 years)	12,053
3	10% × CU46,000	4,600	7%	0.8163 (at 7% for 3 years)	3,755
Total					41,846

The entity will recognise a warranty obligation of CU41,846 at the end of 20X0 for products sold in 20X0.

Example 5 Refunds policy

- 21A.5 A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

Present obligation as a result of a past obligating event—The obligating event is the sale of the product, which gives rise to a constructive obligation because the conduct of the store has created a valid expectation on the part of its customers that the store will refund purchases.

An outflow of resources embodying economic benefits in settlement—Probable that a proportion of goods will be returned for refund.

Conclusion—The entity recognises a provision for the best estimate of the amount required to settle the refunds.

Example 6 Closure of a division—no implementation before end of reporting period

- 21A.6 On 12 December 20X0 the board of an entity decided to close down a division. Before the end of the reporting period (31 December 20X0) the decision was not communicated to any of those affected and no other steps were taken to implement the decision.

Present obligation as a result of a past obligating event—There has been no obligating event, and so there is no obligation.

Conclusion—The entity does not recognise a provision.

Example 7 Closure of a division—communication and implementation before end of reporting period

- 21A.7 On 12 December 20X0 the board of an entity decided to close a division making a particular product. On 20 December 20X0 a detailed plan for closing the division was agreed by the board, letters were sent to customers warning them to seek an alternative source of supply, and redundancy notices were sent to the staff of the division.

Present obligation as a result of a past obligating event—The obligating event is the communication of the decision to the customers and employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be closed.

An outflow of resources embodying economic benefits in settlement—Probable.

Conclusion—The entity recognises a provision at 31 December 20X0 for the best estimate of the costs that would be incurred to close the division at the reporting date.

Example 8 Staff retraining as a result of changes in the income tax system

- 21A.8 The government introduces changes to the income tax system. As a result of those changes, an entity in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with tax regulations. At the end of the reporting period, no retraining of staff has taken place.

Present obligation as a result of a past obligating event—The tax law change does not impose an obligation on an entity to do any retraining. An obligating event for recognising a provision (the retraining itself) has not taken place.

Conclusion—The entity does not recognise a provision.

Example 9 A court case

- 21A.9 A customer has sued Entity X, seeking damages for injury the customer allegedly sustained from using a product sold by Entity X. Entity X disputes liability on grounds that the customer did not follow directions in using the product. Up to the date the board authorised the financial statements for the year to 31 December 20X1 for issue, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to 31 December 20X2, its lawyers advise that, owing to developments in the case, it is now probable that the entity will be found liable.

- (a) At 31 December 20X1

Present obligation as a result of a past obligating event—On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

Conclusion—No provision is recognised. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

(b) At 31 December 20X2

Present obligation as a result of a past obligating event—On the basis of the evidence available, there is a present obligation. The obligating event is the sale of the product to the customer.

An outflow of resources embodying economic benefits in settlement—Probable.

Conclusion—A provision is recognised at the best estimate of the amount to settle the obligation at 31 December 20X2, and the expense is recognised in profit or loss. It is not a correction of an error in 20X1 because, on the basis of the evidence available when the 20X1 financial statements were approved, a provision should not have been recognised at that time.

SECTION 22

LIABILITIES AND EQUITY

Scope of this section

- 22.1 This section establishes principles for classifying financial instruments as either liabilities or equity and addresses accounting for equity instruments issued to individuals or other parties acting in their capacity as investors in **equity** instruments (ie in their capacity as **owners**). Section 26 *Share-based Payment* addresses accounting for a transaction in which the entity receives goods or services (including employee services) as consideration for its equity instruments (including shares or share options) from employees and other vendors acting in their capacity as vendors of goods and services.
- 22.2 This section shall be applied when classifying all types of financial instruments except:
- (a) those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with Section 9 *Consolidated and Separate Financial Statements*, Section 14 *Investments in Associates* or Section 15 *Interests in Joint Ventures*.
 - (b) employers' rights and obligations under employee benefit plans, to which Section 28 *Employee Benefits* applies.
 - (c) contracts for contingent consideration in a business combination (see Section 19 *Business Combinations and Goodwill*). This exemption applies only to the acquirer.
 - (d) financial instruments, contracts and obligations under share-based payment transactions to which Section 26 applies, except that paragraphs 22.3–22.6 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.
 - (e) **insurance contracts** (including **reinsurance contracts**) that it issues and reinsurance contracts that it holds.
 - (f) financial instruments issued by an entity with a **discretionary participation feature**.

A reporting entity that issues or holds financial instruments set out in (e) and (f) is required by paragraph 1.4 to apply IFRS 4 *Insurance Contracts* (as adopted in the EU).

Classification of an instrument as liability or equity

- 22.3 Equity is the residual interest in the assets of an entity after deducting all its liabilities. A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. Equity includes investments by the **owners** of the entity, plus additions to those investments earned through profitable operations and retained for use in the entity's operations, minus reductions to owners' investments as a result of unprofitable operations and distributions to owners.
- 22.3A A financial instrument, where the issuer does not have the unconditional right to avoid settling in cash or by delivery of another financial asset (or otherwise to settle it in such a way that it would be a financial liability) and where settlement is dependent on the occurrence or non-occurrence of uncertain future events beyond the control of the issuer and the holder 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 the features and meets the conditions in paragraphs 22.4.
- 22.4 Some financial instruments that meet the definition of a **liability** are classified as equity because they represent the residual interest in the net assets of the entity:
- (a) A puttable instrument is a financial instrument that gives the holder the right to sell that instrument back to the issuer for cash or another financial asset or is automatically redeemed or repurchased by the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder. A puttable instrument that has all of the following features is classified as an equity instrument:
 - (i) 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.
 - (ii) The instrument is in the class of instruments that is subordinate to all other classes of instruments.
 - (iii) All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features.
 - (iv) 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 unfavourable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments.
 - (v) The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity over the life of the instrument (excluding any effects of the instrument).
 - (b) Instruments, or components of instruments, that are subordinate to all other classes of instruments are classified as equity if they 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.
- 22.5 The following are examples of instruments that are classified as liabilities rather than equity:
- (a) An instrument of the type described in 22.4(b) is classified as a liability if the distribution of net assets on liquidation is subject to a maximum amount (a ceiling). For example, if in liquidation the holders of the instrument receive a pro rata share of the net assets, but this amount is limited to a ceiling and the excess net assets are distributed to a charity organisation or the government, the instrument is not classified as equity.
 - (b) A puttable instrument is classified as equity if, when the put option is exercised, the holder receives a pro rata share of the net assets of the entity measured in accordance with this [draft] FRS. However, if the holder is entitled to an amount measured on some other basis (such as local GAAP), the instrument is classified as a liability.

- (c) An instrument is classified as a liability if it obliges the entity to make payments to the holder before liquidation, such as a mandatory dividend.
- (d) A puttable instrument that is classified as equity in a subsidiary's financial statements is classified as a liability in the consolidated **group** financial statements.
- (e) 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.

22.6 Members' shares in co-operative entities and similar instruments are equity if:

- (a) the entity has an unconditional right to refuse redemption of the members' shares, or
- (b) redemption is unconditionally prohibited by local law, regulation or the entity's governing charter.

Original issue of shares or other equity instruments

22.7 An entity shall recognise the issue of shares or other equity instruments as equity when it issues those instruments and another party is obliged to provide cash or other resources to the entity in exchange for the instruments.

- (a) [Not used]
- (b) If the entity receives the cash or other resources before the equity instruments are issued, and the entity cannot be required to repay the cash or other resources received, the entity shall recognise the corresponding increase in equity to the extent of consideration received.
- (c) To the extent that the equity instruments have been subscribed for but not issued (called up), and the entity has not yet received the cash or other resources, the entity shall not recognise an increase in equity.

22.8 An entity shall measure the equity instruments at the fair value of the cash or other resources received or receivable, net of direct costs of issuing the equity instruments. If payment is deferred and the time value of money is material, the initial measurement shall be on a **present value** basis.

22.9 An entity shall account for the transaction costs of an equity transaction as a deduction from equity, net of any related income tax benefit.

22.10 How the increase in equity arising on the issue of shares or other equity instruments is presented in the statement of financial position is determined by applicable laws. For example, the par value (or other nominal value) of shares and the amount paid in excess of par value may be presented separately.

Sale of options, rights and warrants

22.11 An entity shall apply the principles in paragraphs 22.7–22.10 to equity issued by means of sales of options, rights, warrants and similar equity instruments.

Capitalisation or bonus issues of shares and share splits

- 22.12 A capitalisation or bonus issue (sometimes referred to as a stock dividend) is the issue of new shares to shareholders in proportion to their existing holdings. For example, an entity may give its shareholders one dividend or bonus share for every five shares held. A share split (sometimes referred to as a stock split) is the dividing of an entity's existing shares into multiple shares. For example, in a share split, each shareholder may receive one additional share for each share held. In some cases, the previously outstanding shares are cancelled and replaced by new shares. Capitalisation and bonus issues and share splits do not change total equity. An entity shall reclassify amounts within equity as required by applicable laws.

Convertible debt or similar compound financial instruments

- 22.13 On issuing convertible debt or similar compound **financial instruments** that contain both a liability and an equity component, an entity shall allocate the proceeds between the liability component and the equity component. To make the allocation, the entity shall first determine the amount of the liability component as the fair value of a similar liability that does not have a conversion feature or similar associated equity component. The entity shall allocate the residual amount as the equity component. Transaction costs shall be allocated between the debt component and the equity component on the basis of their relative fair values.
- 22.14 The entity shall not revise the allocation in a subsequent period.
- 22.15 In periods after the instruments were issued, the entity shall systematically recognise any difference between the liability component and the principal amount payable at maturity as additional interest expense using the **effective interest method** (see paragraphs 11.15–11.20). The appendix to this section illustrates the issuer's accounting for convertible debt.

Treasury shares

- 22.16 Treasury shares are the equity instruments of an entity that have been issued and subsequently reacquired by the entity. An entity shall deduct from equity the fair value of the consideration given for the treasury shares. The entity shall not recognise a gain or loss in profit or loss on the purchase, sale, issue or cancellation of treasury shares.

Distributions to owners

- 22.17 An entity shall reduce equity for the amount of distributions to its owners (holders of its equity instruments), net of any related income tax benefits.
- 22.18 An entity shall disclose the fair value of any non-cash assets that have been distributed to its owners during the reporting period, except when the non-cash assets are ultimately controlled by the same parties both before and after the distribution.

Non-controlling interest and transactions in shares of a consolidated subsidiary

- 22.19 In **consolidated financial statements**, a non-controlling interest in the net assets of a subsidiary is included in equity. An entity shall treat changes in a parent's controlling interest in a subsidiary that do not result in a loss of **control** as transactions with equity holders in their capacity as equity holders. Accordingly, the carrying amount of the non-controlling interest shall be adjusted to reflect the change in the parent's interest in the subsidiary's net assets. Any difference between the amount by which the non-controlling interest is so adjusted and the fair value of the consideration paid or received, if any, shall be recognised directly in equity and attributed to equity holders of the parent. An entity shall not recognise gain or loss on these changes. Also, an entity shall not recognise any change in the **carrying amounts** of assets (including goodwill) or liabilities as a result of such transactions.

APPENDIX TO SECTION 22

EXAMPLE OF THE ISSUER'S ACCOUNTING FOR CONVERTIBLE DEBT

The Appendix accompanies, but is not part of, Section 22. It provides guidance for applying the requirements of paragraphs 22.13–22.15.

On 1 January 20X5 an entity issues 500 convertible bonds. The bonds are issued at par with a face value of CU100 per bond and are for a five-year term, with no transaction costs. The total proceeds from the issue are CU50,000. Interest is payable annually in arrears at an annual interest rate of 4 per cent. Each bond is convertible, at the holder's discretion, into 25 ordinary shares at any time up to maturity. At the time the bonds are issued, the market interest rate for similar debt that does not have the conversion option is 6 per cent.

When the instrument is issued, the liability component must be valued first, and the difference between the total proceeds on issue (which is the fair value of the instrument in its entirety) and the fair value of the liability component is assigned to the equity component. The fair value of the liability component is calculated by determining its present value using the discount rate of 6 per cent. The calculations and journal entries are illustrated below:

	CU
Proceeds from the bond issue (A)	50,000
Present value of principal at the end of five years (see calculations below)	37,363
Present value of interest payable annually in arrears for five years	8,425
Present value of liability, which is the fair value of liability component (B)	45,788
Residual, which is the fair value of the equity component (A) – (B)	4,212

The issuer of the bonds makes the following journal entry at issue on 1 January 20X5:

Dr Cash	CU50,000	
Cr Financial Liability – Convertible bond		CU45,788
Cr Equity		CU4,212

The CU4,212 represents a discount on issue of the bonds, so the entry could also be shown 'gross':

Dr Cash	CU50,000	
Dr Bond discount	CU4,212	
Cr Financial Liability – Convertible bond		CU50,000
Cr Equity		CU4,212

After issue, the issuer will amortise the bond discount according to the following table:

	(a) Interest payment (CU)	(b) Total interest expense (CU) = 6% x (e)	(c) Amortisation of bond discount (CU) = (b) – (a)	(d) Bond discount (CU) = (d) – (c)	(e) Net liability (CU) = 50,000 – (d)
1/1/20X5				4,212	45,788
31/12/20X5	2,000	2,747	747	3,465	46,535
31/12/20X6	2,000	2,792	792	2,673	47,327
31/12/20X7	2,000	2,840	840	1,833	48,167
31/12/20X8	2,000	2,890	890	943	49,057
31/12/20X9	2,000	2,943	943	0	50,000
Totals	10,000	14,212	4,212		

At the end of 20X5, the issuer would make the following journal entry:

Dr Interest expense	CU2,747	
Cr Bond discount		CU747
Cr Cash		CU2,000

Calculations

Present value of principal of CU50,000 at 6 per cent

$$CU50,000 / (1.06)^5 = 37,363$$

Present value of the interest annuity of CU2,000 (= CU50,000 × 4 per cent) payable at the end of each of five years

The CU2,000 annual interest payments are an annuity—a cash flow stream with a limited number (n) of periodic payments (C), receivable at dates 1 to n. To calculate the present value of this annuity, future payments are discounted by the periodic rate of interest (i) using the following formula:

$$PV = C/i \times [1 - a/(1+i)^5]$$

Therefore, the present value of the CU2,000 interest payments is $(2,000/.06) \times [1 - (1/1.06)^5] = 8,425$

This is equivalent to the sum of the present values of the five individual CU2,000 payments, as follows:

	CU
Present value of interest payment at 31 December 20X5 = $2,000/1.06$	1,887
Present value of interest payment at 31 December 20X6 = $2,000/1.06^2$	1,780
Present value of interest payment at 31 December 20X7 = $2,000/1.06^3$	1,679
Present value of interest payment at 31 December 20X8 = $2,000/1.06^4$	1,584
Present value of interest payment at 31 December 20X9 = $2,000/1.06^5$	1,495
Total	8,425

Yet another way to calculate this is to use a table of present value of an ordinary annuity in arrears, five periods, interest rate of 6 per cent per period. (Such tables are easily found on the Internet.) The present value factor is 4.2124. Multiplying this by the annuity payment of CU2,000 determines the present value of CU8,425.

SECTION 23

REVENUE

Scope of this section

- 23.1 This section shall be applied in accounting for **revenue** arising from the following transactions and events:
- (a) the sale of goods (whether produced by the entity for the purpose of sale or purchased for resale).
 - (b) the rendering of services.
 - (c) construction contracts in which the entity is the contractor.
 - (d) the use by others of entity assets yielding interest, royalties or dividends.
- 23.2 Revenue or other **income** arising from some transactions and events is dealt with in other sections of this [draft] FRS:
- (a) lease agreements (see Section 20 *Leases*).
 - (b) dividends and other income arising from investments that are accounted for using the equity method (see Section 14 *Investments in Associates* and Section 15 *Investments in Joint Ventures*).
 - (c) changes in the **fair value** of **financial assets** and **financial liabilities** or their disposal (see Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*).
 - (d) changes in the fair value of **investment property** (see Section 16 *Investment Property*).
 - (e) initial **recognition** and changes in the fair value of **biological assets** related to agricultural activity (see Section 34 *Specialised Activities*).
 - (f) initial recognition of **agricultural produce** (see Section 34).

Measurement of revenue

- 23.3 An entity shall measure revenue at the fair value of the consideration received or receivable. The fair value of the consideration received or receivable takes into account the amount of any trade discounts, prompt settlement discounts and volume rebates allowed by the entity.
- 23.4 An entity shall include in revenue only the gross inflows of economic benefits received and receivable by the entity on its own account. An entity shall exclude from revenue all amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes. In an agency relationship, an entity shall include in revenue only the amount of its commission. The amounts collected on behalf of the principal are not revenue of the entity.

Deferred payment

- 23.5 When the inflow of cash or cash equivalents is deferred, and the arrangement constitutes in effect a financing transaction, the fair value of the consideration is the **present value** of all future receipts determined using an **imputed rate of interest**. A financing transaction arises when, for example, an entity provides interest-free credit to the buyer or accepts a note

receivable bearing a below-market interest rate from the buyer as consideration for the sale of goods. The imputed rate of interest is the more clearly determinable of either:

- (a) the prevailing rate for a similar instrument of an issuer with a similar credit rating, or
- (b) a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

An entity shall recognise the difference between the present value of all future receipts and the nominal amount of the consideration as interest revenue in accordance with paragraphs 23.28 and 23.29 and Section 11.

Exchanges of goods or services

23.6 An entity shall not recognise revenue:

- (a) when goods or services are exchanged for goods or services that are of a similar nature and value, or
- (b) when goods or services are exchanged for dissimilar goods or services but the transaction lacks commercial substance.

23.7 An entity shall recognise revenue when goods are sold or services are exchanged for dissimilar goods or services in a transaction that has commercial substance. In that case, the entity shall measure the transaction at

- (a) the fair value of the goods or services received adjusted by the amount of any cash or cash equivalents transferred; or
- (b) if the amount under (a) cannot be measured reliably, then at the fair value of the goods or services given up adjusted by the amount of any cash or cash equivalents transferred; or
- (c) if the fair value of neither the asset received nor the asset given up can be measured reliably, then at the **carrying amount** of the asset given up adjusted by the amount of any cash or cash equivalents transferred.

Identification of the revenue transaction

23.8 An entity usually applies the revenue recognition criteria in this section separately to each transaction. However, an entity applies the recognition criteria to the separately identifiable components of a single transaction when necessary to reflect the substance of the transaction. For example, an entity applies the recognition criteria to the separately identifiable components of a single transaction when the selling price of a product includes an identifiable amount for subsequent servicing. Conversely, an entity applies the recognition criteria to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole. For example, an entity applies the recognition criteria to two or more transactions together when it sells goods and, at the same time, enters into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction.

23.9 Sometimes, as part of a sales transaction, an entity grants its customer a loyalty award that the customer may redeem in the future for free or discounted goods or services. In this case, in accordance with paragraph 23.8, the entity shall account for the award credits as a separately identifiable component of the initial sales transaction. The entity shall allocate the fair value of the consideration received or receivable in respect of the initial sale between the award credits and the other components of the sale. The consideration allocated to the award credits shall be

measured by reference to their fair value, ie the amount for which the award credits could be sold separately.

Sale of goods

- 23.10 An entity shall recognise revenue from the sale of goods when all the following conditions are satisfied:
- (a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods.
 - (b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.
 - (c) the amount of revenue can be measured reliably.
 - (d) it is **probable** that the economic benefits associated with the transaction will flow to the entity.
 - (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.
- 23.11 The assessment of when an entity has transferred the significant risks and rewards of ownership to the buyer requires an examination of the circumstances of the transaction. In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the buyer. This is the case for most retail sales. In other cases, the transfer of risks and rewards of ownership occurs at a time different from the transfer of legal title or the passing of possession.
- 23.12 An entity does not recognise revenue if it retains significant risks of ownership. Examples of situations in which the entity may retain the significant risks and rewards of ownership are:
- (a) when the entity retains an obligation for unsatisfactory performance not covered by normal warranties.
 - (b) when the receipt of the revenue from a particular sale is contingent on the buyer selling the goods.
 - (c) when the goods are shipped subject to installation and the installation is a significant part of the contract that has not yet been completed.
 - (d) when the buyer has the right to rescind the purchase for a reason specified in the sales contract, or at the buyer's sole discretion without any reason, and the entity is uncertain about the probability of return.
- 23.13 If an entity retains only an insignificant risk of ownership, the transaction is a sale and the entity recognises the revenue. For example, a seller recognises revenue when it retains the legal title to the goods solely to protect the collectibility of the amount due. Similarly an entity recognises revenue when it offers a refund if the customer finds the goods faulty or is not satisfied for other reasons, and the entity can estimate the returns reliably. In such cases, the entity recognises a provision for returns in accordance with Section 21 *Provisions and Contingencies*.

Rendering of services

- 23.14 When the outcome of a transaction involving the rendering of services can be estimated reliably, an entity shall recognise revenue associated with the transaction by reference to the stage of completion of the transaction at the end of the **reporting period** (sometimes referred

to as the percentage of completion method). The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

- (a) the amount of revenue can be measured reliably.
- (b) it is probable that the economic benefits associated with the transaction will flow to the entity.
- (c) the stage of completion of the transaction at the end of the reporting period can be measured reliably.
- (d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

Paragraphs 23.21–23.27 provide guidance for applying the percentage of completion method.

- 23.15 When services are performed by an indeterminate number of acts over a specified period of time, an entity recognises revenue on a straight-line basis over the specified period unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other act, the entity postpones recognition of revenue until the significant act is executed.
- 23.16 When the outcome of the transaction involving the rendering of services cannot be estimated reliably, an entity shall recognise revenue only to the extent of the expenses recognised that are recoverable.

Construction contracts

- 23.17 When the outcome of a **construction contract** can be estimated reliably, an entity shall recognise contract revenue and contract costs associated with the construction contract as revenue and expenses respectively by reference to the stage of completion of the contract activity at the end of the reporting period (often referred to as the percentage of completion method). Reliable estimation of the outcome requires reliable estimates of the stage of completion, future costs and collectibility of billings. Paragraphs 23.21–23.27 provide guidance for applying the percentage of completion method.
- 23.18 The requirements of this section are usually applied separately to each construction contract. However, in some circumstances, it is necessary to apply this section to the separately identifiable components of a single contract or to a group of contracts together in order to reflect the substance of a contract or a group of contracts.
- 23.19 When a contract covers a number of assets, the construction of each asset shall be treated as a separate construction contract when:
- (a) separate proposals have been submitted for each asset;
 - (b) each asset has been subject to separate negotiation, and the contractor and customer are able to accept or reject that part of the contract relating to each asset; and
 - (c) the costs and revenues of each asset can be identified.
- 23.20 A group of contracts, whether with a single customer or with several customers, shall be treated as a single construction contract when:
- (a) the group of contracts is negotiated as a single package;

- (b) the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and
- (c) the contracts are performed concurrently or in a continuous sequence.

Percentage of completion method

- 23.21 This method is used to recognise revenue from rendering services (see paragraphs 23.14–23.16) and from construction contracts (see paragraphs 23.17–23.20). An entity shall review and, when necessary, revise the estimates of revenue and costs as the service transaction or construction contract progresses.
- 23.22 An entity shall determine the stage of completion of a transaction or contract using the method that measures most reliably the work performed. Possible methods include:
- (a) the proportion that costs incurred for work performed to date bear to the estimated total costs. Costs incurred for work performed to date do not include costs relating to future activity, such as for materials or prepayments.
 - (b) surveys of work performed.
 - (c) completion of a physical proportion of the service transaction or contract work.
- Progress payments and advances received from customers often do not reflect the work performed.
- 23.23 An entity shall recognise costs that relate to future activity on the transaction or contract, such as for materials or prepayments, as an asset if it is probable that the costs will be recovered.
- 23.24 An entity shall recognise as an expense immediately any costs whose recovery is not probable.
- 23.25 When the outcome of a construction contract cannot be estimated reliably:
- (a) an entity shall recognise revenue only to the extent of contract costs incurred that it is probable will be recoverable, and
 - (b) the entity shall recognise contract costs as an expense in the period in which they are incurred.
- 23.26 When it is probable that total contract costs will exceed total contract revenue on a construction contract, the expected loss shall be recognised as an expense immediately, with a corresponding provision for an onerous contract (see Section 21).
- 23.27 If the collectibility of an amount already recognised as contract revenue is no longer probable, the entity shall recognise the uncollectible amount as an expense rather than as an adjustment of the amount of contract revenue.

Interest, royalties and dividends

- 23.28 An entity shall recognise revenue arising from the use by others of entity assets yielding interest, royalties and dividends on the bases set out in paragraph 23.29 when:
- (a) it is probable that the economic benefits associated with the transaction will flow to the entity, and
 - (b) the amount of the revenue can be measured reliably.

23.29 An entity shall recognise revenue on the following bases:

- (a) interest shall be recognised using the **effective interest method** as described in paragraphs 11.15–11.20.
- (b) royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement.
- (c) dividends shall be recognised when the shareholder's right to receive payment is established.

Disclosures

General disclosures about revenue

23.30 An entity shall disclose:

- (a) the **accounting policies** adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services.
- (b) the amount of each category of revenue recognised during the period, showing separately, at a minimum, revenue arising from:
 - (i) the sale of goods.
 - (ii) the rendering of services.
 - (iii) interest.
 - (iv) royalties.
 - (v) dividends.
 - (vi) commissions.
 - (vii) grants.
 - (viii) any other significant types of revenue.

Disclosures relating to revenue from construction contracts

23.31 An entity shall disclose the following:

- (a) the amount of contract revenue recognised as revenue in the period.
- (b) the methods used to determine the contract revenue recognised in the period.
- (c) the methods used to determine the stage of completion of contracts in progress.

23.32 An entity shall present:

- (a) the gross amount due from customers for contract work, as an asset.
- (b) the gross amount due to customers for contract work, as a liability.

APPENDIX TO SECTION 23

EXAMPLES OF REVENUE RECOGNITION UNDER THE PRINCIPLES IN SECTION 23

This Appendix accompanies, but is not part of, Section 23. It provides guidance for applying the requirements of Section 23 in recognising revenue.

- 23A.1 The following examples focus on particular aspects of a transaction and are not a comprehensive discussion of all the relevant factors that might influence the recognition of revenue. The examples generally assume that the amount of revenue can be measured reliably, it is probable that the economic benefits will flow to the entity and the costs incurred or to be incurred can be measured reliably.

Sale of goods

- 23A.2 The law in different countries may cause the recognition criteria in Section 23 to be met at different times. In particular, the law may determine the point in time at which the entity transfers the significant risks and rewards of ownership. Therefore, the examples in this appendix need to be read in the context of the laws relating to the sale of goods in the country in which the transaction takes place.

Example 1 ‘Bill and hold’ sales, in which delivery is delayed at the buyer’s request but the buyer takes title and accepts billing

- 23A.3 The seller recognises revenue when the buyer takes title, provided:

- (a) it is probable that delivery will be made;
- (b) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognised;
- (c) the buyer specifically acknowledges the deferred delivery instructions; and
- (d) the usual payment terms apply.

Revenue is not recognised when there is simply an intention to acquire or manufacture the goods in time for delivery.

Example 2 Goods shipped subject to conditions: installation and inspection

- 23A.4 The seller normally recognises revenue when the buyer accepts delivery, and installation and inspection are complete. However, revenue is recognised immediately upon the buyer’s acceptance of delivery when:
- (a) the installation process is simple, for example the installation of a factory-tested television receiver that requires only unpacking and connection of power and antennae, or
 - (b) the inspection is performed only for the purposes of final determination of contract prices, for example, shipments of iron ore, sugar or soya beans.

Example 3 Goods shipped subject to conditions: on approval when the buyer has negotiated a limited right of return

- 23A.5 If there is uncertainty about the possibility of return, the seller recognises revenue when the shipment has been formally accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed.

Example 4 Goods shipped subject to conditions: consignment sales under which the recipient (buyer) undertakes to sell the goods on behalf of the shipper (seller)

- 23A.6 The shipper recognises revenue when the goods are sold by the recipient to a third party.

Example 5 Goods shipped subject to conditions: cash on delivery sales

- 23A.7 The seller recognises revenue when delivery is made and cash is received by the seller or its agent.

Example 6 Layaway sales under which the goods are delivered only when the buyer makes the final payment in a series of instalments

- 23A.8 The seller recognises revenue from such sales when the goods are delivered. However, when experience indicates that most such sales are consummated, revenue may be recognised when a significant deposit is received, provided the goods are on hand, identified and ready for delivery to the buyer.

Example 7 Orders when payment (or partial payment) is received in advance of delivery for goods not currently held in inventory, for example, the goods are still to be manufactured or will be delivered direct to the buyer from a third party

- 23A.9 The seller recognises revenue when the goods are delivered to the buyer.

Example 8 Sale and repurchase agreements (other than swap transactions) under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to repurchase, or the buyer has a put option to require the repurchase, by the seller, of the goods

- 23A.10 For a sale and repurchase agreement on an asset other than a financial asset, the seller must analyse the terms of the agreement to ascertain whether, in substance, the risks and rewards of ownership have been transferred to the buyer. If they have been transferred, the seller recognises revenue. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue. For a sale and repurchase agreement on a financial asset, the derecognition provisions of Section 11 apply.

Example 9 Sales to intermediate parties, such as distributors, dealers or others for resale

- 23A.11 The seller generally recognises revenue from such sales when the risks and rewards of ownership have been transferred. However, when the buyer is acting, in substance, as an agent, the sale is treated as a consignment sale.

Example 10 Subscriptions to publications and similar items

- 23A.12 When the items involved are of similar value in each time period, the seller recognises revenue on a straight-line basis over the period in which the items are dispatched. When the items vary in value from period to period, the seller recognises revenue on the basis of the sales value of the item dispatched in relation to the total estimated sales value of all items covered by the subscription.

Example 11 Instalment sales, under which the consideration is receivable in instalments

- 23A.13 The seller recognises revenue attributable to the sales price, exclusive of interest, at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The seller recognises the interest element as revenue using the effective interest method.

Example 12 Agreements for the construction of real estate

- 23A.14 An entity that undertakes the construction of real estate, directly or through subcontractors, and enters into an agreement with one or more buyers before construction is complete, shall account for the agreement as a sale of services, using the percentage of completion method, only if:
- (a) the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether it exercises that ability or not), or
 - (b) the buyer acquires and supplies construction materials and the entity provides only construction services.
- 23A.15 If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver real estate to the buyer, the agreement shall be accounted for as the sale of goods. In this case, the buyer does not obtain control or the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. Rather, the transfer occurs only on delivery of the completed real estate to the buyer.

Example 13 Sale with customer loyalty award

- 23A.16 An entity sells product A for CU100. Purchasers of product A get an award credit enabling them to buy product B for CU10. The normal selling price of product B is CU18. The entity estimates that 40 per cent of the purchasers of product A will use their award to buy product B at CU10. The normal selling price of product A, after taking into account discounts that are usually offered but that are not available during this promotion, is CU95.
- 23A.17 The fair value of the award credit is $40 \text{ per cent} \times [\text{CU}18 - \text{CU}10] = \text{CU}3.20$. The entity allocates the total revenue of CU100 between product A and the award credit by reference to their relative fair values of CU95 and CU3.20 respectively. Therefore:
- (a) Revenue for product A is $\text{CU}100 \times [\text{CU}95 / (\text{CU}95 + \text{CU}3.20)] = \text{CU}96.74$
 - (b) Revenue for product B is $\text{CU}100 \times [\text{CU}3.20 / (\text{CU}95 + \text{CU}3.20)] = \text{CU}3.26$

Rendering of services

Example 14 Installation fees

- 23A.18 The seller recognises installation fees as revenue by reference to the stage of completion of the installation, unless they are incidental to the sale of a product, in which case they are recognised when the goods are sold.

Example 15 Servicing fees included in the price of the product

- 23A.19 When the selling price of a product includes an identifiable amount for subsequent servicing (eg after sales support and product enhancement on the sale of software), the seller defers that amount and recognises it as revenue over the period during which the service is performed.

The amount deferred is that which will cover the expected costs of the services under the agreement, together with a reasonable profit on those services.

Example 16 Advertising commissions

- 23A.20 Media commissions are recognised when the related advertisement or commercial appears before the public. Production commissions are recognised by reference to the stage of completion of the project.

Example 17 Insurance agency commissions

- 23A.21 Insurance agency commissions received or receivable that do not require the agent to render further service are recognised as revenue by the agent on the effective commencement or renewal dates of the related policies. However, when it is probable that the agent will be required to render further services during the life of the policy, the agent defers the commission, or part of it, and recognises it as revenue over the period during which the policy is in force.

Example 18 Admission fees

- 23A.22 The seller recognises revenue from artistic performances, banquets and other special events when the event takes place. When a subscription to a number of events is sold, the seller allocates the fee to each event on a basis that reflects the extent to which services are performed at each event.

Example 19 Tuition fees

- 23A.23 The seller recognises revenue over the period of instruction

Example 20 Initiation, entrance and membership fees

- 23A.24 Revenue recognition depends on the nature of the services provided. If the fee permits only membership, and all other services or products are paid for separately, or if there is a separate annual subscription, the fee is recognised as revenue when no significant uncertainty about its collectibility exists. If the fee entitles the member to services or publications to be provided during the membership period, or to purchase goods or services at prices lower than those charged to non-members, it is recognised on a basis that reflects the timing, nature and value of the benefits provided.

Franchise fees

- 23A.25 Franchise fees may cover the supply of initial and subsequent services, equipment and other tangible assets, and know how. Accordingly, franchise fees are recognised as revenue on a basis that reflects the purpose for which the fees were charged. The following methods of franchise fee recognition are appropriate.

Example 21 Franchise fees: Supplies of equipment and other tangible assets

- 23A.26 The franchisor recognises the fair value of the assets sold as revenue when the items are delivered or title passes.

Example 22 Franchise fees: Supplies of initial and subsequent services

- 23A.27 The franchisor recognises fees for the provision of continuing services, whether part of the initial fee or a separate fee, as revenue as the services are rendered. When the separate fee does not cover the cost of continuing services together with a reasonable profit, part of the initial

fee, sufficient to cover the costs of continuing services and to provide a reasonable profit on those services, is deferred and recognised as revenue as the services are rendered.

- 23A.28 The franchise agreement may provide for the franchisor to supply equipment, inventories, or other tangible assets at a price lower than that charged to others or a price that does not provide a reasonable profit on those sales. In these circumstances, part of the initial fee, sufficient to cover estimated costs in excess of that price and to provide a reasonable profit on those sales, is deferred and recognised over the period the goods are likely to be sold to the franchisee. The balance of an initial fee is recognised as revenue when performance of all the initial services and other obligations required of the franchisor (such as assistance with site selection, staff training, financing and advertising) has been substantially accomplished.
- 23A.29 The initial services and other obligations under an area franchise agreement may depend on the number of individual outlets established in the area. In this case, the fees attributable to the initial services are recognised as revenue in proportion to the number of outlets for which the initial services have been substantially completed.
- 23A.30 If the initial fee is collectible over an extended period and there is a significant uncertainty that it will be collected in full, the fee is recognised as cash instalments are received.

Example 23 Franchise fees: Continuing franchise fees

- 23A.31 Fees charged for the use of continuing rights granted by the agreement, or for other services provided during the period of the agreement, are recognised as revenue as the services are provided or the rights used.

Example 24 Franchise fees: Agency transactions

- 23A.32 Transactions may take place between the franchisor and the franchisee that, in substance, involve the franchisor acting as agent for the franchisee. For example, the franchisor may order supplies and arrange for their delivery to the franchisee at no profit. Such transactions do not give rise to revenue.

Example 25 Fees from the development of customised software

- 23A.33 The software developer recognises fees from the development of customised software as revenue by reference to the stage of completion of the development, including completion of services provided for post-delivery service support.

Interest, royalties and dividends

Example 26 Licence fees and royalties

- 23A.34 The licensor recognises fees and royalties paid for the use of an entity's assets (such as trademarks, patents, software, music copyright, record masters and motion picture films) in accordance with the substance of the agreement. As a practical matter, this may be on a straight-line basis over the life of the agreement, for example, when a licensee has the right to use specified technology for a specified period of time.
- 23A.35 An assignment of rights for a fixed fee or non-refundable guarantee under a non-cancellable contract that permits the licensee to exploit those rights freely and the licensor has no remaining obligations to perform is, in substance, a sale. An example is a licensing agreement for the use of software when the licensor has no obligations after delivery. Another example is the granting of rights to exhibit a motion picture film in markets in which the licensor has no control over the distributor and expects to receive no further revenues from the box office receipts. In such cases, revenue is recognised at the time of sale.

23A.36 In some cases, whether or not a licence fee or royalty will be received is contingent on the occurrence of a future event. In such cases, revenue is recognised only when it is probable that the fee or royalty will be received, which is normally when the event has occurred.

SECTION 24

GRANTS

Scope of this section

- 24.1 This section specifies the accounting for all grants by government and others. A **government grant** is assistance by government in the form of a transfer of resources to an entity in return for past or future compliance with specified conditions relating to the operating activities of the entity.
- 24.2 Government grants exclude those forms of government assistance that cannot reasonably have a value placed upon them and transactions with government that cannot be distinguished from the normal trading transactions of the entity.
- 24.3 This section does not cover government assistance that is provided for an entity in the form of benefits that are available in determining taxable profit or tax loss, or are determined or limited on the basis of income tax liability. Examples of such benefits are income tax holidays, investment tax credits, accelerated depreciation allowances and reduced income tax rates. Section 29 *Income Tax* covers accounting for taxes based on income.

Recognition and measurement

- 24.3A Grants, including non-monetary grants shall not be recognised until there is reasonable assurance that:
- (a) the entity will comply with the conditions attaching to them; and
 - (b) the grants will be received.
- 24.4 An entity shall recognise grants either based on the performance model or an accrual model.
- 24.5 An entity shall measure grants at the **fair value** of the asset received or receivable.
- 24.5A Where a grant becomes repayable it shall be recognised as a liability when the repayment meets the definition of a liability.

Performance model

- 24.5B An entity applying the performance model shall recognise grants as follows:
- (a) A grant that does not impose specified future performance conditions on the recipient is recognised in income when the grant proceeds are receivable.
 - (b) A grant that imposes specified future performance conditions on the recipient is recognised in income only when the performance conditions are met.
 - (c) Grants received before the revenue recognition criteria are satisfied are recognised as a liability.

Accrual model

- 24.5C An entity applying the accrual model shall classify grants either as a grant relating to revenue or a grant relating to assets.

- 24.5D Grants relating to revenue shall be recognised in income on a systematic basis over the periods in which the entity recognises the related costs for which the grant is intended to compensate.
- 24.5E A grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised in income in the period in which it becomes receivable.
- 24.5F Grants relating to assets shall be recognised in the income on a systematic basis over the expected useful life of the asset.
- 24.5G Where part of a grant relating to an asset is deferred it shall be recognised as deferred income and not deducted from the carrying value of the asset.

Disclosures

- 24.6 An entity shall disclose the following about grants:
- (a) the accounting policy adopted for grants in accordance with paragraph 24.4.
 - (b) the nature and amounts of grants recognised in the financial statements.
 - (c) unfulfilled conditions and other contingencies attaching to grants that have not been recognised in income.
 - (d) an indication of other forms of government assistance from which the entity has directly benefited.
- 24.7 For the purpose of the disclosure required by paragraph 24.6(d), government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under specified criteria. Examples include free technical or marketing advice, the provision of guarantees, and loans at nil or low interest rates.

SECTION 25

BORROWING COSTS

Scope of this section

- 25.1 This section specifies the accounting for **borrowing costs**. Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds. Borrowing costs include:
- (a) interest expense calculated using the effective interest method as described in Section 11 *Basic Financial Instruments*.
 - (b) finance charges in respect of finance leases recognised in accordance with Section 20 *Leases*.
 - (c) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Recognition

- 25.2 An entity may adopt a policy of capitalising borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Where an entity adopts a policy of capitalisation of borrowing costs, then it should be applied consistently to all qualifying assets. Where an entity does not adopt a policy of capitalising borrowing costs all borrowing costs shall recognised as an expense in profit or loss in the period in which they are incurred.
- 25.2A The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made.
- 25.2B To the extent that an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation as the actual borrowing costs incurred on that borrowing during the period less any investment income on that temporary investment of that borrowing.
- 25.2C Where the funds applied to obtain a qualifying asset form part of the entity's general borrowings, the amount of borrowing costs eligible for capitalisation is determined by applying a capitalisation rate to the expenditure on that asset. For this purpose the expenditure on the asset is the average carrying amount of the asset during the period, including borrowing costs previously capitalised. The capitalisation rate used in an accounting period shall be the weighted average of rates applicable to the entity's general borrowings that are outstanding during the period. This excludes borrowings by the entity that are specifically for the purpose of obtaining other qualifying assets. The amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period.
- 25.2D An entity shall capitalise borrowing costs as part of the cost of a qualifying asset from the point when it first incurs both expenditure on the asset and borrowing costs, and undertakes activities necessary to prepare the asset for its intended use or sale. Capitalisation shall be suspended during extended periods where active development of the asset has paused, and ceased when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Disclosures

25.3 Paragraph 5.5 requires the items to be included in the profit and loss account in accordance with Schedule 1 to the Regulations. The Regulations require disclosure of finance costs. Paragraph 11.48(b) requires disclosure of total interest expense (using the **effective interest method**) for financial liabilities that are not at fair value through profit or loss. When a policy of capitalising borrowing costs is not adopted, this section does not require any additional disclosure.

25.3A An entity shall disclose:

- (a) the amount of borrowing costs capitalised in the period; and
- (b) the capitalisation rate used.

SECTION 26

SHARE-BASED PAYMENT

Scope of this section

- 26.1 This section specifies the accounting for all **share-based payment transactions** including:
- (a) **equity-settled share-based payment** transactions, in which the entity acquires goods or services as consideration for **equity** instruments of the entity (including shares or share options);
 - (b) **cash-settled share-based payment** transactions, in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity; and
 - (c) transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments.
- 26.2 Cash-settled share-based payment transactions include share appreciation rights. For example, an entity might grant share appreciation rights to employees as part of their remuneration package, whereby the employees will become entitled to a future cash payment (rather than an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time. Or an entity might grant to its employees a right to receive a future cash payment by granting to them a right to shares (including shares to be issued upon the exercise of share options) that are redeemable, either mandatorily (eg upon cessation of employment) or at the employee's option.

Recognition

- 26.3 An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction.
- 26.4 When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, the entity shall recognise them as expenses.

Recognition when there are vesting conditions

- 26.5 If the share-based payments granted to employees **vest** immediately, the employee is not required to complete a specified period of service before becoming unconditionally entitled to those share-based payments. In the absence of evidence to the contrary, the entity shall presume that services rendered by the employee as consideration for the share-based payments have been received. In this case, on grant date the entity shall recognise the services received in full, with a corresponding increase in equity or liabilities.
- 26.6 If the share-based payments do not vest until the employee completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those share-based payments will be received in the future, during the vesting

period. The entity shall account for those services as they are rendered by the employee during the vesting period, with a corresponding increase in equity or liabilities.

Measurement of equity-settled share-based payment transactions

Measurement principle

- 26.7 For equity-settled share-based payment transactions, an entity shall measure the goods or services received, and the corresponding increase in equity, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, by reference to the fair value of the equity instruments granted. To apply this requirement to transactions with employees and others providing similar services, the entity shall measure the fair value of the services received by reference to the fair value of the equity instruments granted, because typically it is not possible to estimate reliably the fair value of the services received.
- 26.8 For transactions with employees (including others providing similar services), the fair value of the equity instruments shall be measured at grant date. For transactions with parties other than employees, the measurement date is the date when the entity obtains the goods or the counterparty renders service.
- 26.9 A grant of equity instruments might be conditional on employees satisfying specified vesting conditions related to service or performance. For example, a grant of shares or share options to an employee is typically conditional on the employee remaining in the entity's employ for a specified period of time. There might be performance conditions that must be satisfied, such as the entity achieving a specified growth in profit (a non-market vesting condition) or a specified increase in the entity's share price (a market vesting condition). All vesting conditions related to solely employee service or to a non-market performance condition shall be taken into account when estimating the number of equity instruments expected to vest. Subsequently, the entity shall revise that estimate, if necessary, if new information indicates that the number of equity instruments expected to vest differs from previous estimates. On vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested. All market vesting conditions and non-vesting conditions shall be taken into account when estimating the fair value of the shares or share options at the measurement date, with no subsequent adjustment irrespective of the outcome.

Shares

- 26.10 An entity shall measure the fair value of shares (and the related goods or services received) using the following three-tier measurement hierarchy:
- (a) If an observable market price is available for the equity instruments granted, use that price.
 - (b) If an observable market price is not available, measure the fair value of equity instruments granted using entity-specific observable market data such as
 - (i) a recent transaction in the entity's shares, or
 - (ii) a recent independent fair valuation of the entity or its principal assets.
 - (c) If an observable market price is not available and obtaining a reliable measurement of fair value under (b) is **impracticable**, indirectly measure the fair value of the shares or share appreciation rights using a valuation method that uses market data to the greatest extent practicable to estimate what the price of those equity instruments would be on the grant date in an arm's length transaction between knowledgeable, willing parties. The entity's

directors should use their judgement to apply a generally accepted valuation methodology for valuing equity instruments that is appropriate to the circumstances of the entity.

Share options and equity-settled share appreciation rights

- 26.11 An entity shall measure the fair value of share options and equity-settled share appreciation rights (and the related goods or services received) using the following three-tier measurement hierarchy:
- (a) If an observable market price is available for the equity instruments granted, use that price.
 - (b) If an observable market price is not available, measure the fair value of share options and share appreciation rights granted using entity-specific observable market data such as (a) for a recent transaction in the share options.
 - (c) If an observable market price is not available and obtaining a reliable measurement of fair value under (b) is impracticable, indirectly measure the fair value of share options or share appreciation rights using an alternative valuation methodology such as option pricing model. The inputs for an option pricing model (such as the weighted average share price, exercise price, expected volatility, option life, expected dividends, and the risk-free interest rate) should use market data to the greatest extent possible. Paragraph 26.10 provides guidance on determining the fair value of the shares used in determining the weighted average share price. The entity should derive an estimate of expected volatility consistent with the valuation methodology used to determine the fair value of the shares.

Modifications to the terms and conditions on which equity instruments were granted

- 26.12 If an entity modifies the vesting conditions in a manner that is beneficial to the employee, for example, by reducing the exercise price of an option or reducing the vesting period or by modifying or eliminating a performance condition, the entity shall take the modified vesting conditions into account in accounting for the share-based payment transaction, as follows:
- (a) If the modification increases the fair value of the equity instruments granted (or increases the number of equity instruments granted) measured immediately before and after the modification, the entity shall include the incremental fair value granted in the measurement of the amount recognised for services received as consideration for the equity instruments granted. The incremental fair value granted is the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.
 - (b) If the modification reduces the total fair value of the share-based payment arrangement, or apparently is not otherwise beneficial to the employee, the entity shall nevertheless continue to account for the services received as consideration for the equity instruments granted as if that modification had not occurred.

Cancellations and settlements

- 26.13 An entity shall account for a cancellation or settlement of an equity-settled share-based payment award as an acceleration of vesting, and therefore shall recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period.

Cash-settled share-based payment transactions

- 26.14 For cash-settled share-based payment transactions, an entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity shall remeasure the fair value of the liability at each **reporting date** and at the date of settlement, with any changes in fair value recognised in profit or loss for the period.

Share-based payment transactions with cash alternatives

- 26.15 Some share-based payment transactions give either the entity or the counterparty a choice of settling the transaction in cash (or other assets) or by transfer of equity instruments. In such a case, the entity shall account for the transaction as a cash-settled share-based payment transaction unless either

- (a) the entity has a past practice of settling by issuing equity instruments, or
- (b) the option has no commercial substance because the cash settlement amount bears no relationship to, and is likely to be lower in value than, the fair value of the equity instrument.

In circumstances (a) and (b), the entity shall account for the transaction as an equity-settled share-based payment transaction in accordance with paragraphs 26.7–26.13.

Group plans

- 26.16 If a share-based payment award is granted by an entity to the employees of one or more members in the group, the members are permitted to recognise and measure the share-based payment expense on the basis of a reasonable allocation of the expense for the group.

Government-mandated plans

- 26.17 Some jurisdictions have programmes established under law by which equity investors (such as employees) are able to acquire equity without providing goods or services that can be specifically identified (or by providing goods or services that are clearly less than the fair value of the equity instruments granted). This indicates that other consideration has been or will be received (such as past or future employee services). These are equity-settled share-based payment transactions within the scope of this section. The entity shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received) measured at the grant date.

Disclosures

- 26.18 An entity shall disclose the following information about the nature and extent of share-based payment arrangements that existed during the period:
- (a) a description of each type of share-based payment arrangement that existed at any time during the period, including the general terms and conditions of each arrangement, such as vesting requirements, the maximum term of options granted, and the method of settlement (eg whether in cash or equity). An entity with substantially similar types of share-based payment arrangements may aggregate this information.

- (b) the number and weighted average exercise prices of share options for each of the following groups of options:
 - (i) outstanding at the beginning of the period.
 - (ii) granted during the period.
 - (iii) forfeited during the period.
 - (iv) exercised during the period.
 - (v) expired during the period.
 - (vi) outstanding at the end of the period.
 - (vii) exercisable at the end of the period.
- 26.19 For equity-settled share-based payment arrangements, an entity shall disclose information about how it measured the fair value of goods or services received or the value of the equity instruments granted. If a valuation methodology was used, the entity shall disclose the method and its reason for choosing it.
- 26.20 For cash-settled share-based payment arrangements, an entity shall disclose information about how the liability was measured.
- 26.21 For share-based payment arrangements that were modified during the period, an entity shall disclose an explanation of those modifications.
- 26.22 If the entity is part of a group share-based payment plan, and it recognises and measures its share-based payment expense on the basis of a reasonable allocation of the expense recognised for the group, it shall disclose that fact and the basis for the allocation (see paragraph 26.16).
- 26.23 An entity shall disclose the following information about the effect of share-based payment transactions on the entity's profit or loss for the period and on its financial position:
- (a) the total expense recognised in profit or loss for the period.
 - (b) the total carrying amount at the end of the period for liabilities arising from share-based payment transactions.

SECTION 27

IMPAIRMENT OF ASSETS

Objective and scope

- 27.1 An **impairment loss** occurs when the **carrying amount** of an asset exceeds its **recoverable amount**. This section shall be applied in accounting for the impairment of all assets other than the following, for which other sections of this [draft] FRS establish impairment requirements:
- (a) **deferred tax assets** (see Section 29 *Income Tax*).
 - (b) assets arising from **employee benefits** (see Section 28 *Employee Benefits*).
 - (c) **financial assets** within the scope of Section 11 *Basic Financial Instruments* or Section 12 *Other Financial Instruments Issues*.
 - (d) **investment property** measured at **fair value** (see Section 16 *Investment Property*).
 - (e) **biological assets** related to agricultural activity measured at fair value less estimated costs to sell (see Section 34 *Specialised Activities*).

Impairment of inventories

Selling price less costs to complete and sell

- 27.2 An entity shall assess at each **reporting date** whether any inventories are impaired. The entity shall make the assessment by comparing the **carrying amount** of each item of inventory (or group of similar items—see paragraph 27.3) with its selling price less costs to complete and sell. If an item of inventory (or group of similar items) is impaired, the entity shall reduce the carrying amount of the inventory (or the group) to its selling price less costs to complete and sell. That reduction is an impairment loss and it is recognised immediately in profit or loss.
- 27.3 If it is **impracticable** to determine the selling price less costs to complete and sell for inventories item by item, the entity may group items of inventory relating to the same product line that have similar purposes or end uses and are produced and marketed in the same geographical area for the purpose of assessing impairment.

Reversal of impairment

- 27.4 An entity shall make a new assessment of selling price less costs to complete and sell at each subsequent reporting date. When the circumstances that previously caused inventories to be impaired no longer exist or when there is clear evidence of an increase in selling price less costs to complete and sell because of changed economic circumstances, the entity shall reverse the amount of the impairment (ie the reversal is limited to the amount of the original impairment loss) so that the new carrying amount is the lower of the cost and the revised selling price less costs to complete and sell.

Impairment of assets other than inventories

General principles

- 27.5 If, and only if, the recoverable amount of an asset is less than its carrying amount, the entity shall reduce the carrying amount of the asset to its recoverable amount. That reduction is an impairment loss. Paragraphs 27.11–27.20 provide guidance on measuring recoverable amount.

- 27.6 An entity shall recognise an impairment loss immediately in profit or loss, unless the asset is carried at a revalued amount in accordance with another section of this [draft] FRS (for example, in accordance with the revaluation model in Section 17 *Property, Plant and Equipment*). Any impairment loss of a revalued asset shall be treated as a revaluation decrease in accordance with that other section.

Indicators of impairment

- 27.7 An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset. If there is no indication of impairment, it is not necessary to estimate the recoverable amount.
- 27.8 If it is not possible to estimate the recoverable amount of the individual asset, an entity shall estimate the recoverable amount of the **cash-generating unit** to which the asset belongs. This may be the case because measuring recoverable amount requires forecasting cash flows, and sometimes individual assets do not generate cash flows by themselves. An asset's cash-generating unit is the smallest identifiable group of assets that includes the asset and generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.
- 27.9 In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:

External sources of information

- (a) During the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use.
- (b) Significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated.
- (c) Market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect materially the discount rate used in calculating an asset's value in use and decrease the asset's fair value less costs to sell.
- (d) The carrying amount of the net assets of the entity is more than the estimated fair value of the entity as a whole (such an estimate may have been made, for example, in relation to the potential sale of part or all of the entity).

Internal sources of information

- (e) Evidence is available of obsolescence or physical damage of an asset.
 - (f) Significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite.
 - (g) Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected. In this context economic performance includes operating results and cash flows.
- 27.10 If there is an indication that an asset may be impaired, this may indicate that the entity should review the remaining useful life, the **depreciation (amortisation)** method or the **residual**

value for the asset and adjust it in accordance with the section of this [draft] FRS applicable to the asset (eg Section 17 *Property, Plant and Equipment* and Section 18 *Intangible Assets other than Goodwill*), even if no impairment loss is recognised for the asset.

Measuring recoverable amount

- 27.11 The recoverable amount of an asset or a cash-generating unit is the higher of its **fair value less costs to sell** and its **value in use**. If it is not possible to estimate the recoverable amount of an individual asset, references in paragraphs 27.12–27.20 to an asset should be read as references also to an asset’s cash-generating unit.
- 27.12 It is not always necessary to determine both an asset’s fair value less costs to sell and its value in use. If either of these amounts exceeds the asset’s carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.
- 27.13 If there is no reason to believe that an asset’s value in use materially exceeds its fair value less costs to sell, the asset’s fair value less costs to sell may be used as its recoverable amount. This will often be the case for an asset that is held for disposal.

Fair value less costs to sell

- 27.14 Fair value less costs to sell is the amount obtainable from the sale of an asset in an arm’s length transaction between knowledgeable, willing parties, less the costs of disposal. The best evidence of the fair value less costs to sell of an asset is a price in a binding sale agreement in an arm’s length transaction or a market price in an active market. If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available to reflect the amount that an entity could obtain, at the reporting date, from the disposal of the asset in an arm’s length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, an entity considers the outcome of recent transactions for similar assets within the same industry.
- 27.14A When determining an asset’s fair value less cost to sell, consideration shall be given to any restrictions imposed on that asset. Cost to sell should also include the cost of obtaining relaxation of a restriction where necessary in order to enable the asset to be sold. If a restriction would also apply to any potential purchaser of an asset, the fair value of the asset may be lower than that of an asset whose use is not restricted.
- 27.14B For assets held for their service potential a cash flow driven valuation may not be appropriate. In these circumstances, **value in use (in respect of assets held for their service potential)** is determined by the present value of the asset’s remaining service potential plus the net amount the entity will receive from its disposal. In some cases, this may be taken to be costs avoided by possession of the asset. Therefore, **depreciated replacement cost**, may be a suitable measurement model but other approaches may be used where more appropriate.

Value in use

- 27.15 Value in use is the **present value** of the future cash flows expected to be derived from an asset. This present value calculation involves the following steps:
- (a) estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal, and
 - (b) applying the appropriate discount rate to those future cash flows.
- 27.16 The following elements shall be reflected in the calculation of an asset’s value in use:
- (a) an estimate of the future cash flows the entity expects to derive from the asset.

- (b) expectations about possible variations in the amount or timing of those future cash flows.
- (c) the time value of money, represented by the current market risk-free rate of interest.
- (d) the price for bearing the uncertainty inherent in the asset.
- (e) other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

27.17 In measuring value in use, estimates of future cash flows shall include:

- (a) projections of cash inflows from the continuing use of the asset.
- (b) projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset for use) and can be directly attributed, or allocated on a reasonable and consistent basis, to the asset.
- (c) net cash flows, if any, expected to be received (or paid) for the disposal of the asset at the end of its useful life in an arm's length transaction between knowledgeable, willing parties.

The entity may wish to use any recent financial budgets or forecasts to estimate the cash flows, if available. To estimate cash flow projections beyond the period covered by the most recent budgets or forecasts an entity may wish to extrapolate the projections based on the budgets or forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified.

27.18 Estimates of future cash flows shall not include:

- (a) cash inflows or outflows from financing activities, or
- (b) income tax receipts or payments.

27.19 Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:

- (a) a future restructuring to which an entity is not yet committed, or
- (b) improving or enhancing the asset's performance.

27.20 The discount rate (rates) used in the present value calculation shall be a pre-tax rate (rates) that reflect(s) current market assessments of:

- (a) the time value of money, and
- (b) the risks specific to the asset for which the future cash flow estimates have not been adjusted.

The discount rate (rates) used to measure an asset's value in use shall not reflect risks for which the future cash flow estimates have been adjusted, to avoid double-counting.

Recognising and measuring an impairment loss for a cash-generating unit

- 27.21 An impairment loss shall be recognised for a cash-generating unit if, and only if, the recoverable amount of the unit is less than the carrying amount of the unit. The impairment loss shall be allocated to reduce the carrying amount of the assets of the unit in the following order:
- (a) first, to reduce the carrying amount of any goodwill allocated to the cash-generating unit, and
 - (b) then, to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the cash-generating unit.
- 27.22 However, an entity shall not reduce the carrying amount of any asset in the cash-generating unit below the highest of:
- (a) its fair value less costs to sell (if determinable);
 - (b) its value in use (if determinable); and
 - (c) zero.
- 27.23 Any excess amount of the impairment loss that cannot be allocated to an asset because of the restriction in paragraph 27.22 shall be allocated to the other assets of the unit pro rata on the basis of the carrying amount of those other assets.

Additional requirements for impairment of goodwill

- 27.24 Goodwill, by itself, cannot be sold. Nor does it generate cash flows to an entity that are independent of the cash flows of other assets. As a consequence, the fair value of goodwill cannot be measured directly. Therefore, the fair value of goodwill must be derived from measurement of the fair value of the cash-generating unit(s) of which the goodwill is a part.
- 27.25 For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.
- 27.26 Part of the recoverable amount of a cash-generating unit is attributable to the non-controlling interest in goodwill. For the purpose of impairment testing a non-wholly-owned cash-generating unit with goodwill, the carrying amount of that unit is notionally adjusted, before being compared with its recoverable amount, by grossing up the carrying amount of goodwill allocated to the unit to include the goodwill attributable to the non-controlling interest. This notionally adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the cash-generating unit is impaired.
- 27.27 If goodwill cannot be allocated to individual cash-generating units (or groups of cash-generating units) on a non-arbitrary basis, then for the purposes of testing goodwill the entity shall test the impairment of goodwill by determining the recoverable amount of either (a) or (b):
- (a) the acquired entity in its entirety, if the goodwill relates to an acquired entity that has not been integrated. Integrated means the acquired business has been restructured or dissolved into the reporting entity or other subsidiaries.
 - (b) the entire group of entities, excluding any entities that have not been integrated, if the goodwill relates to an entity that has been integrated.

In applying this paragraph, an entity will need to separate goodwill into goodwill relating to entities that have been integrated and goodwill relating to entities that have not been integrated. Also the entity shall follow the requirements for cash-generating units in this section when calculating the recoverable amount of, and allocating impairment losses and reversals to assets belonging to, the acquired entity or group of entities.

Reversal of an impairment loss

- 27.28 An impairment loss recognised for goodwill shall be reversed in a subsequent period if and only if the reasons for the impairment loss have ceased to apply.
- 27.29 For all assets other than goodwill, an entity shall assess at each reporting date whether there is any indication that an impairment loss recognised in prior periods may no longer exist or may have decreased. Indications that an impairment loss may have decreased or may no longer exist are generally the opposite of those set out in paragraph 27.9. If any such indication exists, the entity shall determine whether all or part of the prior impairment loss should be reversed. The procedure for making that determination will depend on whether the prior impairment loss on the asset was based on:
- (a) the recoverable amount of that individual asset (see paragraph 27.30), or
 - (b) the recoverable amount of the cash-generating unit to which the asset belongs (see paragraph 27.31).

Reversal where recoverable amount was estimated for an individual impaired asset

- 27.30 When the prior impairment loss was based on the recoverable amount of the individual impaired asset, the following requirements apply:
- (a) The entity shall estimate the recoverable amount of the asset at the current reporting date.
 - (b) If the estimated recoverable amount of the asset exceeds its carrying amount, the entity shall increase the carrying amount to recoverable amount, subject to the limitation described in (c) below. That increase is a reversal of an impairment loss. The entity shall recognise the reversal immediately in profit or loss.
 - (c) The reversal of an impairment loss shall not increase the carrying amount of the asset above the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.
 - (d) After a reversal of an impairment loss is recognised, the entity shall adjust the depreciation (amortisation) charge for the asset in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Reversal when recoverable amount was estimated for a cash-generating unit

- 27.31 When the original impairment loss was based on the recoverable amount of the cash-generating unit to which the asset belongs, the following requirements apply:
- (a) The entity shall estimate the recoverable amount of that cash-generating unit at the current reporting date.
 - (b) If the estimated recoverable amount of the cash-generating unit exceeds its carrying amount, that excess is a reversal of an impairment loss. The entity shall allocate the amount of that reversal to the assets of the unit, except for goodwill, pro rata with the carrying amounts of those assets, subject to the limitation described in (c) below. Those increases in carrying amounts shall be treated as reversals of impairment losses for individual assets and recognised immediately in profit or loss.

- (c) In allocating a reversal of an impairment loss for a cash-generating unit, the reversal shall not increase the carrying amount of any asset above the lower of
 - (i) its recoverable amount, and
 - (ii) the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior periods.
- (d) Any excess amount of the reversal of the impairment loss that cannot be allocated to an asset because of the restriction in (c) above shall be allocated pro rata to the other assets of the cash-generating unit, except for goodwill.
- (e) After a reversal of an impairment loss is recognised, if applicable, the entity shall adjust the depreciation (amortisation) charge for each asset in the cash-generating unit in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Disclosures

27.32 An entity shall disclose the following for each **class of assets** indicated in paragraph 27.33:

- (a) the amount of impairment losses recognised in profit or loss during the period and the line item(s) in the statement of comprehensive income (and in the income statement, if presented) in which those impairment losses are included.
- (b) the amount of reversals of impairment losses recognised in profit or loss during the period and the line item(s) in the statement of comprehensive income (and in the income statement, if presented) in which those impairment losses are reversed.

27.33 An entity shall disclose the information required by paragraph 27.32 for each of the following classes of asset:

- (a) inventories.
- (b) property, plant and equipment (including investment property accounted for by the cost method).
- (c) goodwill.
- (d) intangible assets other than goodwill.
- (e) investments in associates.
- (f) investments in joint ventures.

SECTION 28

EMPLOYEE BENEFITS

Scope of this section

- 28.1 Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees, including directors and management. This section applies to all employee benefits, except for **share-based payment transactions**, which are covered by Section 26 *Share-based Payment*. Employee benefits covered by this section will be one of the following four types:
- (a) short-term employee benefits, which are employee benefits (other than **termination benefits**) that are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service.
 - (b) **post-employment benefits**, which are employee benefits (other than termination benefits and short-term employee benefits) that are payable after the completion of employment.
 - (c) other long-term employee benefits, which are employee benefits (other than short-term employee benefits, post-employment benefits and termination benefits).
 - (d) termination benefits, which are employee benefits provided in exchange for the termination of an employee's employment as a result of either:
 - (i) an entity's decision to terminate an employee's employment before the normal retirement date, or
 - (ii) an employee's decision to accept voluntary redundancy in exchange for those benefits.
- 28.2 Employee benefits also include share-based payment transactions by which employees receive equity instruments (such as shares or share options) or cash or other assets of the entity in amounts that are based on the price of the entity's shares or other equity instruments of the entity. An entity shall apply Section 26 in accounting for share-based payment transactions.

General recognition principle for all employee benefits

- 28.3 An entity shall recognise the cost of all employee benefits to which its employees have become entitled as a result of service rendered to the entity during the **reporting period**:
- (a) as a liability, after deducting amounts that have been paid either directly to the employees or as a contribution to an employee benefit fund. If the amount paid exceeds the obligation arising from service before the **reporting date**, an entity shall recognise that excess as an asset to the extent that the prepayment will lead to a reduction in future payments or a cash refund.
 - (b) as an expense, unless another section of this [draft] FRS requires the cost to be recognised as part of the cost of an asset such as inventories or property, plant and equipment.

Short-term employee benefits

Examples

28.4 Short-term employee benefits include items such as:

- (a) wages, salaries and social security contributions;
- (b) short-term compensated absences (such as paid annual leave and paid sick leave) when the absences are expected to occur within twelve months after the end of the period in which the employees render the related employee service;
- (c) profit-sharing and bonuses payable within twelve months after the end of the period in which the employees render the related service; and
- (d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

Measurement of short-term benefits generally

28.5 When an employee has rendered service to an entity during the reporting period, the entity shall measure the amounts recognised in accordance with paragraph 28.3 at the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service.

Recognition and measurement—short-term compensated absences

- 28.6 An entity may compensate employees for absence for various reasons including annual vacation leave and sick leave. Some short-term compensated absences accumulate—they can be carried forward and used in future periods if the employee does not use the current period's entitlement in full. Examples include annual vacation leave and sick leave. An entity shall recognise the expected cost of **accumulating compensated absences** when the employees render service that increases their entitlement to future compensated absences. The entity shall measure the expected cost of accumulating compensated absences at the undiscounted 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. The entity shall present this amount as falling due within one year at the reporting date.
- 28.7 An entity shall recognise the cost of other (non-accumulating) compensated absences when the absences occur. The entity shall measure the cost of non-accumulating compensated absences at the undiscounted amount of salaries and wages paid or payable for the period of absence.

Recognition—profit-sharing and bonus plans

- 28.8 An entity shall recognise the expected cost of profit-sharing and bonus payments only when:
- (a) the entity has a present legal or **constructive obligation** to make such payments as a result of past events (this means that the entity has no realistic alternative but to make the payments), and
 - (b) a reliable estimate of the obligation can be made.

Post-employment benefits: distinction between defined contribution plans and defined benefit plans

28.9 Post-employment benefits include, for example:

- (a) retirement benefits, such as pensions, and
- (b) other post-employment benefits, such as post-employment life insurance and post-employment medical care.

Arrangements whereby an entity provides post-employment benefits are **post-employment benefit plans**. An entity shall apply this section to all such arrangements whether or not they involve the establishment of a separate entity to receive contributions and to pay benefits. In some cases, these arrangements are imposed by law rather than by action of the entity. In some cases, these arrangements arise from actions of the entity even in the absence of a formal, documented plan.

28.10 Post-employment benefit plans are classified as either **defined contribution plans** or **defined benefit plans**, depending on their principal terms and conditions.

- (a) Defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and has no legal or constructive obligation to pay further contributions or to make direct benefit payments to employees if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. 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 insurer, together with investment returns arising from the contributions.
- (b) Defined benefit plans are post-employment benefit plans other than defined contribution plans. Under defined benefit plans, the entity's obligation is to provide the agreed benefits to current and former employees, and actuarial risk (that benefits will cost more or less than expected) and investment risk (that returns on assets set aside to fund the benefits will differ from expectations) are borne, in substance, by the entity. If actuarial or investment experience is worse than expected, the entity's obligation may be increased, and vice versa if actuarial or investment experience is better than expected.

Multi-employer plans and state plans

28.11 **Multi-employer plans** and state plans are classified as defined contribution plans or defined benefit plans on the basis of the terms of the plan, including any constructive obligation that goes beyond the formal terms. However, if sufficient information is not available to use defined benefit accounting for a multi-employer plan or a state plan that is a defined benefit plan, an entity shall account for the plan in accordance with paragraph 28.13 as if it was a defined contribution plan and make the disclosures required by paragraph 28.40.

Insured benefits

28.12 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 has a legal or constructive obligation either:

- (a) to pay the employee benefits directly when they become 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.

A constructive obligation could arise indirectly through the plan, through the mechanism for setting future premiums, or through a **related party** relationship with the insurer. If the entity retains such a legal or constructive obligation, the entity shall treat the plan as a defined benefit plan.

Post-employment benefits: defined contribution plans

Recognition and measurement

28.13 An entity shall recognise the contribution payable for a period:

- (a) as a liability, after deducting any amount already paid. If contribution payments exceed the contribution due for service before the reporting date, an entity shall recognise that excess as an asset.
- (b) as an expense, unless another section of this [draft] FRS requires the cost to be recognised as part of the cost of an asset such as inventories or property, plant and equipment.

Post-employment benefits: defined benefit plans

Recognition

28.14 In applying the general recognition principle in paragraph 28.3 to defined benefit plans, an entity shall recognise:

- (a) a liability for its obligations under defined benefit plans net of plan assets—its '**defined benefit liability**' (see paragraphs 28.15–28.22).
- (b) recognises the net change in that liability during the period as the cost of its defined benefit plans during the period (see paragraphs 28.23–28.27).

Measurement of the defined benefit liability

28.15 An entity shall measure a defined benefit liability for its obligations under defined benefit plans at the net total of the following amounts:

- (a) the **present value** of its obligations under defined benefit plans (its **defined benefit obligation**) at the reporting date (paragraphs 28.16–28.22 provide guidance for measuring this obligation), minus
- (b) the fair value at the reporting date of **plan assets** (if any) out of which the obligations are to be settled directly. Paragraphs 11.27–11.32 establish requirements for determining the fair values of those plan assets that are **financial assets**.

Inclusion of both vested and unvested benefits

28.16 The present value of an entity's obligations under defined benefit plans at the reporting date shall reflect the estimated amount of benefit that employees have earned in return for their service in the current and prior periods, including benefits that are not yet **vested** (see paragraph 28.26) and including the effects of benefit formulas that give employees greater benefits for later years of service. This requires the entity to determine how much benefit is attributable to the current and prior periods on the basis of the plan's benefit formula 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 influence the cost of the benefit. The actuarial assumptions shall be unbiased (neither imprudent nor excessively conservative), mutually compatible, and selected to lead to the best estimate of the future cash flows that will arise under the plan.

Discounting

- 28.17 An entity shall measure its defined benefit obligation on a discounted **present value** basis. The entity shall determine the rate used to discount the future payments by reference to market yields at the reporting date on high quality corporate bonds. In countries with no deep market in such bonds, the entity shall use the market yields (at the reporting date) on government bonds. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated period of the future payments.

Actuarial valuation method

- 28.18 If an entity is able, without undue cost or effort, to use the **projected unit credit method** to measure its defined benefit obligation and the related expense, it shall do so. If defined benefits are based on future salaries, the projected unit credit method requires an entity to measure its defined benefit obligations on a basis that reflects estimated future salary increases. Additionally, the projected unit credit method requires an entity to make various actuarial assumptions in measuring the defined benefit obligation, including discount rates, the expected rates of return on plan assets, expected rates of salary increases, employee turnover, mortality, and (for defined benefit medical plans) medical cost trend rates.
- 28.19 If an entity is not able, without undue cost or effort, to use the projected unit credit method to measure its obligation and cost under defined benefit plans, the entity is permitted to make the following simplifications in measuring its defined benefit obligation with respect to current employees:
- (a) ignore estimated future salary increases (ie assume current salaries continue until current employees are expected to begin receiving post-employment benefits);
 - (b) ignore future service of current employees (ie assume closure of the plan for existing as well as any new employees); and
 - (c) ignore possible in-service mortality of current employees between the reporting date and the date employees are expected to begin receiving post-employment benefits (ie assume all current employees will receive the post-employment benefits). However, mortality after service (ie life expectancy) will still need to be considered.

An entity that takes advantage of the foregoing measurement simplifications must nonetheless include both vested and unvested benefits in measuring its defined benefit obligation.

- 28.20 This [draft] FRS does not require an entity to engage an independent actuary to perform the comprehensive actuarial valuation needed to calculate its defined benefit obligation. Nor does it require that a comprehensive actuarial valuation must be done annually. In the periods between comprehensive actuarial valuations, if the principal actuarial assumptions have not changed significantly the defined benefit obligation can be measured by adjusting the prior period measurement for changes in employee demographics such as number of employees and salary levels.

Plan introductions, changes, curtailments and settlements

- 28.21 If a defined benefit plan has been introduced or changed in the current period, the entity shall increase or decrease its defined benefit liability to reflect the change, and shall recognise the increase (decrease) as an expense (income) in measuring profit or loss in the current period. Conversely, if a plan has been curtailed (ie benefits or group of covered employees are reduced) or settled (the employer's obligation is completely discharged) in the current period, the defined benefit obligation shall be decreased or eliminated, and the entity shall recognise the resulting gain or loss in profit or loss in the current period.

Defined benefit plan asset

- 28.22 If the present value of the defined benefit obligation at the reporting date is less than the fair value of plan assets at that date, the plan has a surplus. An entity shall recognise a plan surplus as a defined benefit plan asset only to the extent that it is able to recover the surplus either through reduced contributions in the future or through refunds from the plan.

Cost of a defined benefit plan

- 28.23 An entity shall recognise the cost of a defined benefit plan, except to the extent that another section of this [draft] FRS requires part or all of the cost to be recognised as part of the cost of an asset, as follows:

- (a) the change in the defined benefit liability arising from employee service rendered during the reporting period in profit or loss;
- (b) net interest on the defined benefit liability during the reporting period in profit or loss;
- (c) plan introductions, changes, curtailments and settlements in profit or loss (see paragraph 28.21); and
- (d) remeasurement of the defined benefit liability in other comprehensive income.

- 28.24 The net interest on the defined benefit liability shall be determined by multiplying the defined benefit liability by the discount rate in paragraph 28.17, both as determined at the start of the annual reporting period, taking account of any changes in the defined benefit liability during the period as a result of contribution and benefit payments.

- 28.24A The net interest on the defined benefit liability can be viewed as comprising, interest cost on the defined benefit obligation and interest income on plan assets excluding the effect of any surplus that is not recoverable in accordance with paragraph 28.22.

- 28.24B Interest income on plan assets, excluding the effect of any surplus that is not recoverable in accordance with paragraph 28.22, 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 28.17 both as determined at the start of the annual reporting period, taking account of any changes in the net defined benefit liability during the period as a result of contribution and benefit payments. The difference between the interest income on plan assets and the return on plan assets is included in the remeasurement of the defined benefit liability.

- 28.25 Remeasurement of the defined benefit liability comprises:

- (a) actuarial gains and losses; and
- (b) the return on plan assets, excluding amounts included in net interest on the defined benefit liability.

- 28.25A Remeasurement of the defined benefit liability recognised in other comprehensive income shall not be reclassified to profit or loss in a subsequent period.

- 28.26 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 yet vested). Employee service before the vesting date gives rise to a constructive obligation because, at each successive reporting date, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced. In measuring its defined benefit obligation, an entity considers the probability that some employees may not satisfy vesting requirements. Similarly, although some post-employment benefits (such as post-employment medical benefits) become payable only if a specified event occurs when an employee is no longer

employed (such as an illness), 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.

28.27 If defined benefits are reduced for amounts that will be paid to employees under government-sponsored plans, an entity shall measure its defined benefit obligations on a basis that reflects the benefits payable under the government plans, but only if:

- (a) those plans were enacted before the reporting date, or
- (b) past history, or other reliable evidence, indicates that those state benefits will change in some predictable manner, for example, in line with future changes in general price levels or general salary levels.

Reimbursements

28.28 If an entity is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, the entity shall recognise its right to reimbursement as a separate asset. The entity shall measure the asset at fair value. In all other respects, an entity shall treat that asset in the same way as plan assets.

Other long-term employee benefits

28.29 Other long-term employee benefits include, for example:

- (a) long-term compensated absences such as long-service or sabbatical leave.
- (b) long-service benefits.
- (c) long-term disability benefits.
- (d) profit-sharing and bonuses payable twelve months or more after the end of the period in which the employees render the related service.
- (e) deferred compensation paid twelve months or more after the end of the period in which it is earned.

28.30 An entity shall recognise a liability for other long-term employee benefits measured at the net total of the following amounts:

- (a) the present value of the benefit obligation at the reporting date, minus
- (b) the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly.

An entity shall recognise the change in the liability in profit and loss, except to the extent that this [draft] FRS requires or permits their inclusion in the cost of an asset.

Termination benefits

28.31 An entity may be committed, by legislation, by contractual or other agreements with employees or their representatives or by a constructive obligation based on business practice, custom or a desire to act equitably, to make payments (or provide other benefits) to employees when it terminates their employment. Such payments are termination benefits.

Recognition

- 28.32 Because termination benefits do not provide an entity with future economic benefits, an entity shall recognise them as an expense in profit or loss immediately.
- 28.33 When an entity recognises termination benefits, the entity may also have to account for a curtailment of retirement benefits or other employee benefits.
- 28.34 An entity shall recognise termination benefits as a liability and an expense only when the entity is demonstrably committed either:
- (a) to terminate the employment of an employee or group of employees before the normal retirement date, or
 - (b) to provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.
- 28.35 An entity is demonstrably committed to a termination only when the entity has a detailed formal plan for the termination and is without realistic possibility of withdrawal from the plan.

Measurement

- 28.36 An entity shall measure termination benefits at the best estimate of the expenditure that would be required to settle the obligation at the reporting date. In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits shall be based on the number of employees expected to accept the offer.
- 28.37 When termination benefits are due more than twelve months after the end of the reporting period, they shall be measured at their discounted present value.

Group plans

- 28.38 Where an entity participates in a defined benefit plan that shares risks between entities under common control it shall obtain information about the plan as a whole measured in accordance with this [draft] FRS on the basis of assumptions that apply to the plan as a whole. If there is a contractual agreement or stated policy for charging the cost of a defined benefit plan as a whole measured in accordance with this [draft] FRS to individual group entities, the entity shall, in its individual accounts, recognise the cost of a defined benefit plan so charged. If there is no such agreement or policy, the cost of a defined benefit plan shall be recognised in the individual accounts of the group entity which is legally responsible for the plan. The other group entities shall, in their individual accounts, recognise a cost equal to their contribution payable for the period.

Disclosures

Disclosures about short-term employee benefits

- 28.39 This section does not require specific disclosures about short-term employee benefits.

Disclosures about defined contribution plans

- 28.40 An entity shall disclose the amount recognised in profit or loss as an expense for defined contribution plans. If an entity treats a defined benefit multi-employer plan as a defined contribution plan because sufficient information is not available to use defined benefit accounting (see paragraph 28.11) it shall disclose the fact that it is a defined benefit plan and the reason why it is being accounted for as a defined contribution plan, along with any available information about the plan's surplus or deficit and the implications, if any, for the entity.

Disclosures about defined benefit plans

28.41 An entity shall disclose the following information about defined benefit plans (except for any defined multi-employer benefit plans that are accounted for as a defined contribution plans in accordance with paragraph 28.11, for which the disclosures in paragraph 28.40 apply instead). If an entity has more than one defined benefit plan, these disclosures may be made in total, separately for each plan, or in such groupings as are considered to be the most useful:

- (a) a general description of the type of plan, including funding policy.
- (b) [not used].
- (c) a narrative explanation if the entity uses any of the simplifications in paragraph 28.19 in measuring its defined benefit obligation.
- (d) the date of the most recent comprehensive actuarial valuation and, if it was not as of the reporting date, a description of the adjustments that were made to measure the defined benefit obligation at the reporting date.
- (e) a reconciliation of opening and closing balances for each of the following:
 - (i) the defined benefit obligation;
 - (ii) the fair value of plan assets; and
 - (iii) any reimbursement right recognised as an asset.
- (f) Each of the reconciliations in paragraph 28.41(e) shall show each of the following, if applicable:
 - (i) the change in the defined benefit liability arising from employee service rendered during the reporting period in profit or loss;
 - (ii) interest income or expense;
 - (iii) remeasurement of the defined benefit liability, showing separately actuarial gains and losses and the return on plan assets less amounts included in (ii) above; and
 - (iv) plan introductions, changes, curtailments and settlements.
- (g) the total cost relating to defined benefit plans for the period, disclosing separately the amounts
 - (i) recognised in profit or loss as an expense, and
 - (ii) included in the cost of an asset.
- (h) for each major class of plan assets, which shall include, but is not limited to, equity instruments, debt instruments, property, and all other assets, the percentage or amount that each major class constitutes of the fair value of the total plan assets at the reporting date.
- (i) the amounts included in the fair value of plan assets for:
 - (i) each class of the entity's own financial instruments, and
 - (ii) any property occupied by, or other assets used by, the entity.
- (j) the actual return on plan assets.

- (k) the principal actuarial assumptions used, including, when applicable:
 - (i) the discount rates;
 - (ii) [not used];
 - (iii) the expected rates of salary increases;
 - (iv) medical cost trend rates; and
 - (v) any other material actuarial assumptions used.

The reconciliations in (e) and (f) above need not be presented for prior periods.

28.41A If an entity participates in a defined benefit plan that shares risks between entities under common control it (see paragraph 28.38) shall disclose the following information:

- (a) the contractual agreement or stated policy for charging the cost of a defined benefit plan or the fact that there is no policy.
- (b) the policy for determining the contribution to be paid by the entity.
- (c) if the entity accounts for an allocation of the cost of a defined benefit plan all the information required in paragraph 28.41.
- (d) if the entity accounts for the contributions payable for the period the information about the plan as a whole required by paragraph 28.41(a),(c),(d),(h),(i).

This information 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.

Disclosures about other long-term benefits

28.42 For each category of other long-term benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, the amount of its obligation and the extent of **funding** at the reporting date.

Disclosures about termination benefits

28.43 For each category of termination benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, its accounting policy, and the amount of its obligation and the extent of funding at the reporting date.

28.44 When there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists. Section 21 *Provisions and Contingencies* requires an entity to disclose information about its contingent liabilities unless the possibility of an outflow in settlement is remote.

SECTION 29

INCOME TAX

Scope of this section

- 29.1 For the purpose of this [draft] FRS, income tax includes all domestic and foreign taxes that are based on **taxable profit**. **Income tax** also includes taxes, such as withholding taxes, that are payable by a subsidiary, associate or joint venture on distributions to the reporting entity.
- 29.2 This section covers accounting for income tax. It requires an entity to recognise the current and future tax consequences of transactions and other events that have been recognised in the financial statements. These recognised tax amounts comprise **current tax** and **deferred tax**. Current tax is tax payable (refundable) in respect of the taxable profit (tax loss) for the current period or past periods. Deferred tax represents the future tax consequences of transactions and events recognised in the financial statements of the current and previous periods.

Recognition and measurement of current tax

- 29.3 An entity shall recognise a current tax liability for tax payable on taxable profit for the current and past periods. If the amount paid for the current and past periods exceeds the amount payable for those periods, the entity shall recognise the excess as a current tax asset.
- 29.4 An entity shall recognise a current tax asset for the benefit of a tax loss that can be carried back to recover tax paid in a previous period.
- 29.5 An entity shall measure a current tax liability/asset at the amounts it expects to pay (recover) using the tax rates and laws that have been enacted or substantively enacted by the reporting date. An entity shall regard tax rates as substantively enacted when future events required by the enactment process historically have not affected the outcome and are unlikely to do so.

Recognition of deferred tax

- 29.6 Deferred tax shall be recognised in respect of all timing differences at the balance sheet date, except as otherwise required by paragraphs 29.7 to 29.9 below. Timing differences are differences between taxable profits and the income and expense as stated in the financial statements (whether in profit and loss or other comprehensive income) that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in financial statements.
- 29.7 Unrelieved tax losses and other deferred tax assets shall be recognised only to the extent that it is **probable** that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits (the very existence of unrelieved tax losses is strong evidence that there may not be 'other future taxable profits' against which the losses will be relieved).
- 29.8 Deferred tax shall be recognised when the tax allowances for the cost of a fixed asset are received before or after the depreciation of the fixed asset is recognised in profit and loss. If and when all conditions for retaining the tax allowances have been met, the deferred tax shall be reversed.
- 29.9 Deferred tax shall be recognised when income or expenses from a subsidiary, associate, branch, or interest in joint venture have been recognised in the financial statements, and will be assessed to or allowed for tax in a future period, except where:

- (a) the reporting entity is able to control the reversal of the timing difference; and
 - (b) it is probable that the timing difference will not reverse in the foreseeable future.
- 29.10 Where the amount attributed for tax purposes to assets (other than goodwill) and liabilities that are acquired in a business combination differs from their fair value, deferred tax shall be recognised to reflect the future tax consequences with a corresponding adjustment to the amount attributed to goodwill.
- 29.11 Permanent differences are differences between an entity's taxable profits and its results as stated in the financial statements that arise because certain types of income and expenditure are non-taxable or disallowable, or because certain tax charges or allowances have no corresponding amount in the financial statements. Deferred tax shall not be recognised on permanent differences.

Measurement of deferred tax

- 29.12 An entity shall measure a deferred tax liability/asset using the tax rates and laws that have been enacted or substantively enacted by the reporting date that are expected to apply in the periods in which the timing difference is expected to reverse. An entity shall regard tax rates as substantively enacted when future events required by the enactment process historically have not affected the outcome and are unlikely to do so.
- 29.13 When different tax rates apply to different levels of taxable profit, an entity shall measure deferred tax expense/income and related deferred tax liabilities/assets using the average enacted or substantively enacted rates that it expects to be applicable to the taxable profit (tax loss) of the periods in which it expects the deferred tax asset to be realised or the deferred tax liability to be settled.
- 29.14 In some jurisdictions, income taxes are payable at a higher or lower rate if part or all of the profit or retained earnings is paid out as a dividend to shareholders of the entity. In other jurisdictions, income taxes may be refundable or payable if part or all of the profit or retained earnings is paid out as a dividend to shareholders of the entity. In both of those circumstances, an entity shall measure current and deferred taxes at the tax rate applicable to undistributed profits until the entity recognises a liability to pay a dividend. When the entity recognises a liability to pay a dividend, it shall recognise the resulting current or deferred tax liability (asset), and the related tax expense (income).
- 29.15 Deferred tax relating to a non-depreciable asset that is measured using the revaluation model in Section 17 *Property, Plant and Equipment* shall be measured using the tax rates and allowances that apply to sale of the asset.
- 29.16 Deferred tax relating to investment property that is measured at fair value in accordance with Section 16 *Investment Property* shall be measured using the tax rates and allowances that apply to sale of the asset, except for depreciable investment property held within a business model whose objective is to consume substantially all of the economic benefits embodied in the property over time.

Measurement of both current and deferred tax

- 29.17 An entity shall not discount current or deferred tax liabilities or deferred tax assets.

Withholding tax on dividends

- 29.18 When an entity pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders. Outgoing dividends and similar

amounts payable shall be recognised at an amount that includes any withholding tax but excludes other taxes, such as attributable tax credits.

- 29.19 Incoming dividends and similar income receivable shall be recognised at an amount that includes any withholding tax but excludes other taxes, such as attributable tax credits. Any withholding tax suffered shall be shown as part of the tax charge.

Value Added Tax ('VAT')

- 29.20 Turnover shown in the profit and loss account shall exclude VAT on taxable outputs and VAT imputed under the flat rate VAT scheme. Expenses shall exclude recoverable VAT. Irrecoverable VAT allocable to fixed assets and to other items disclosed separately in the financial statements shall be included in their cost where practicable and material.

Presentation

Allocation in comprehensive income and equity

- 29.21 An entity shall recognise changes in a current tax liability/asset and changes in a deferred tax liability/asset as tax expense.
- 29.22 An entity shall recognise tax expense in the same component of total comprehensive income (ie continuing operations, discontinued operations, or other comprehensive income) or equity as the transaction or other event that resulted in the tax expense.

Presentation in the statement of financial position

- 29.23 An entity shall present deferred tax liabilities within provisions for liabilities and deferred tax assets within debtors. Where separately presented, deferred tax assets shall be presented within debtors falling due after more than one year.

Offsetting

- 29.24 An entity shall offset if, and only if, current tax assets and current tax liabilities, or deferred tax assets and deferred tax liabilities, when it has a legally enforceable right to set off the amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Disclosures

- 29.25 An entity shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of the current and deferred tax consequences of recognised transactions and other events.
- 29.26 An entity shall disclose separately the major components of tax expense (income). Such components of tax expense (income) may include:
- (a) current tax expense/income.
 - (b) any adjustments recognised in the period for current tax of prior periods.
 - (c) the amount of deferred tax expense/income relating to the origination and reversal of timing differences.
 - (d) the amount of deferred tax expense/income relating to changes in tax rates or the imposition of new taxes.

- (e) adjustments to deferred tax expense arising from a change in the tax status of the entity or its shareholders.
- (f) the amount of tax expense relating to changes in accounting policies and errors (see Section 10 *Accounting Policies, Estimates and Errors*).

29.27 An entity shall disclose the following separately, where material:

- (a) the aggregate current and deferred tax relating to items that are recognised as items of other comprehensive income.
- (b) an explanation of the significant differences in amounts presented in the statement of comprehensive income and amounts reported to tax authorities.
- (c) a statement, for at least the next three years, of expected significant differences between the current tax charge and the standard rate of tax applied to reported profit or loss for the period and a brief explanation of the reasons for those differences.
- (d) an explanation of changes in the applicable tax rate(s) compared with the previous reporting period.
- (e) the amount of deferred tax liabilities and deferred tax assets at the end of the reporting period for each type of timing difference and for each type of unused tax losses and tax credits.
- (f) the expiry date, if any, of timing differences, unused tax losses and unused tax credits.
- (g) in the circumstances described in paragraph 29.14, an explanation of the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders.

SECTION 30

FOREIGN CURRENCY TRANSLATION

Scope of this section

- 30.1 An entity can conduct foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. In addition, an entity may present its financial statements in a foreign currency. This section prescribes how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a **presentation currency**. Accounting for **financial instruments** denominated in a foreign currency and hedge accounting of foreign currency items are dealt with in Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*.

Functional currency

- 30.2 Each entity shall identify its **functional currency**. An entity's functional currency is the currency of the primary economic environment in which the entity operates.
- 30.3 The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. Therefore, the following are the most important factors an entity considers in determining its functional currency:
- (a) the currency:
 - (i) that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled), and
 - (ii) of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.
 - (b) the currency that mainly influences labour, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled).
- 30.4 The following factors may also provide evidence of an entity's functional currency:
- (a) the currency in which funds from financing activities (issuing debt and equity instruments) are generated.
 - (b) the currency in which receipts from operating activities are usually retained.
- 30.5 The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its subsidiary, branch, associate or joint venture):
- (a) whether the activities of the foreign operation are carried out as an extension of the reporting entity, rather than being carried out with a significant degree of autonomy. An example of the former is when the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it. An example of the latter is when the operation accumulates cash and other **monetary items**, incurs expenses, generates income and arranges borrowings, all substantially in its local currency.

- (b) whether transactions with the reporting entity are a high or a low proportion of the foreign operation's activities.
- (c) whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it.
- (d) whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.

Reporting foreign currency transactions in the functional currency

Initial recognition

- 30.6 A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:
- (a) buys or sells goods or services whose price is denominated in a foreign currency;
 - (b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
 - (c) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.
- 30.7 An entity shall record a foreign currency transaction, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.
- 30.8 The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with this [draft] FRS. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

Reporting at the end of the subsequent reporting periods

- 30.9 At the end of each **reporting period**, an entity shall:
- (a) translate foreign currency monetary items using the closing rate;
 - (b) translate non-monetary items that are measured in terms of historical cost in a foreign currency using the exchange rate at the date of the transaction; and
 - (c) translate non-monetary items that are measured at fair value in a foreign currency using the exchange rates at the date when the fair value was determined.
- 30.10 An entity shall recognise, in profit or loss in the period in which they arise, exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous periods, except as described in paragraph 30.13.
- 30.11 When another section of this [draft] FRS requires a gain or loss on a non-monetary item to be recognised in **other comprehensive income**, an entity shall recognise any exchange component of that gain or loss in other comprehensive income. Conversely, when a gain or

loss on a non-monetary item is recognised in profit or loss, an entity shall recognise any exchange component of that gain or loss in profit or loss.

Net investment in a foreign operation

- 30.12 An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation, and is accounted for in accordance with paragraph 30.13. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.
- 30.13 Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation shall be recognised in profit or loss in the separate financial statements of the reporting entity or the individual accounts of the foreign operation, as appropriate. In the financial statements that include the foreign operation and the reporting entity (eg consolidated financial statements when the foreign operation is a subsidiary), such exchange differences shall be recognised initially in other comprehensive income and reported as a component of equity. They shall not again be recognised in profit or loss on disposal of the net investment.

Change in functional currency

- 30.14 When there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.
- 30.15 As noted in paragraphs 30.2–30.5, the functional currency of an entity reflects the underlying transactions, events and conditions that are relevant to the entity. Accordingly, once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions. For example, a change in the currency that mainly influences the sales prices of goods and services may lead to a change in an entity's functional currency.
- 30.16 The effect of a change in functional currency is accounted for prospectively. In other words, an entity translates all items into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for non-monetary items are treated as their historical cost.

Use of a presentation currency other than the functional currency

Translation to the presentation currency

- 30.17 An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, the entity shall translate its items of income and expense and **financial position** into the presentation currency. For example, when a **group** contains individual entities with different functional currencies, the items of income and expense and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.
- 30.18 An entity whose functional currency is not the currency of a hyperinflationary economy shall translate its results and financial position into a different presentation currency using the following procedures:
- (a) assets and liabilities for each statement of financial position presented (ie including comparatives) shall be translated at the closing rate at the date of that statement of financial position;

- (b) income and expenses for each statement of comprehensive income (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and
 - (c) all resulting exchange differences shall be recognised in other comprehensive income.
- 30.19 For practical reasons, an entity may use a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period, to translate income and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.
- 30.20 The exchange differences referred to in paragraph 30.18(c) result from:
- (a) translating income and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate, and
 - (b) translating the opening net assets at a closing rate that differs from the previous closing rate.

When the exchange differences relate to a foreign operation that is consolidated but not wholly-owned, accumulated exchange differences arising from translation and attributable to the **non-controlling interest** are allocated to, and recognised as part of, non-controlling interest in the consolidated statement of financial position.

- 30.21 An entity whose functional currency is the currency of a hyperinflationary economy shall translate its results and financial position into a different presentation currency using the procedures specified in Section 31 *Hyperinflation*.

Translation of a foreign operation into the investor's presentation currency

- 30.22 In incorporating the assets, liabilities, income and expenses of a foreign operation with those of the reporting entity, the entity shall follow normal consolidation procedures, such as the elimination of intragroup balances and intragroup transactions of a subsidiary (see Section 9 *Consolidated and Separate Financial Statements*). However, an intragroup monetary asset (or liability), whether short-term or long-term, cannot be eliminated against the corresponding intragroup liability (or asset) without showing the results of currency fluctuations in the consolidated financial statements. This is because the monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements, a reporting entity continues to recognise such an exchange difference in profit or loss or, if it arises from the circumstances described in paragraph 30.13, the entity shall classify it as equity.
- 30.23 Any goodwill 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 shall be treated as assets and liabilities of the foreign operation. Thus, they shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraph 30.18.

Disclosures

- 30.24 In paragraphs 30.26 and 30.27, references to 'functional currency' apply, in the case of a group, to the functional currency of the parent.
- 30.25 An entity shall disclose the following:
- (a) the amount of exchange differences recognised in profit or loss during the period, except for those arising on financial instruments measured at fair value through profit or loss in accordance with Sections 11 and 12.

- (b) the amount of exchange differences arising during the period and classified in a separate component of equity at the end of the period.
- 30.26 An entity shall disclose the currency in which the financial statements are presented. When the presentation currency is different from the functional currency, an entity shall state that fact and shall disclose the functional currency and the reason for using a different presentation currency.
- 30.27 When there is a change in the functional currency of either the reporting entity or a significant foreign operation, the entity shall disclose that fact and the reason for the change in functional currency.

SECTION 31

HYPERINFLATION

Scope of this section

- 31.1 This section applies to an entity whose **functional currency** is the currency of a hyperinflationary economy. It requires such an entity to prepare **financial statements** that have been adjusted for the effects of hyperinflation.

Hyperinflationary economy

- 31.2 This section does not establish an absolute rate at which an economy is deemed hyperinflationary. An entity shall make that judgement by considering all available information including, but not limited to, the following possible indicators of hyperinflation:
- (a) The general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power.
 - (b) The general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency.
 - (c) Sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short.
 - (d) Interest rates, wages and prices are linked to a price index.
 - (e) The cumulative inflation rate over three years is approaching, or exceeds, 100 per cent.

Measuring unit in the financial statements

- 31.3 All amounts in the financial statements of an entity whose functional currency is the currency of a hyperinflationary economy shall be stated in terms of the measuring unit current at the end of the **reporting period**. The comparative information for the previous period required by paragraph 3.14, and any information presented in respect of earlier periods, shall also be stated in terms of the measuring unit current at the **reporting date**.
- 31.4 The restatement of financial statements in accordance with this section requires the use of a general price index that reflects changes in general purchasing power. In most economies there is a recognised general price index, normally produced by the government, that entities will follow.

Procedures for restating historical cost financial statements

Statement of financial position

- 31.5 Statement of financial position amounts not expressed in terms of the measuring unit current at the end of the reporting period are restated by applying a general price index.
- 31.6 Monetary items are not restated because they are expressed in terms of the measuring unit current at the end of the reporting period. Monetary items are money held and items to be received or paid in money.

- 31.7 Assets and liabilities linked by agreement to changes in prices, such as index-linked bonds and loans, are adjusted in accordance with the agreement and presented at this adjusted amount in the restated statement of financial position.
- 31.8 All other assets and liabilities are non-monetary:
- (a) Some non-monetary items are carried at amounts current at the end of the reporting period, such as net realisable value and fair value, so they are not restated. All other non-monetary assets and liabilities are restated.
 - (b) Most non-monetary items are carried at cost or cost less depreciation; hence they are expressed at amounts current at their date of acquisition. The restated cost, or cost less depreciation, of each item is determined by applying to its historical cost and accumulated depreciation the change in a general price index from the date of acquisition to the end of the reporting period.
 - (c) The restated amount of a non-monetary item is reduced, in accordance with Section 27 *Impairment of Assets*, when it exceeds its **recoverable amount**.
- 31.9 At the beginning of the first period of application of this section, the components of **equity**, except retained earnings, are restated by applying a general price index from the dates the components were contributed or otherwise arose. Restated retained earnings are derived from all the other amounts in the restated statement of financial position.
- 31.10 At the end of the first period and in subsequent periods, all components of owners' equity are restated by applying a general price index from the beginning of the period or the date of contribution, if later. The changes for the period in owners' equity are disclosed in accordance with Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings*.

Statement of comprehensive income and income statement

- 31.11 All items in the statement of comprehensive income (and in the income statement, if presented) shall be expressed in terms of the measuring unit current at the end of the reporting period. Therefore, all amounts need to be restated by applying the change in the general price index from the dates when the items of income and expenses were initially recognised in the financial statements. If general inflation is approximately even throughout the period, and the items of income and expense arose approximately evenly throughout the period, an average rate of inflation may be appropriate.

Statement of cash flows

- 31.12 An entity shall express all items in the **statement of cash flows** in terms of the measuring unit current at the end of the reporting period.

Gain or loss on net monetary position

- 31.13 In a period of inflation, an entity holding an excess of monetary assets over monetary liabilities loses purchasing power, and an entity with an excess of monetary liabilities over monetary assets gains purchasing power, to the extent the assets and liabilities are not linked to a price level. An entity shall include in profit or loss the gain or loss on the net monetary position. An entity shall offset the adjustment to those assets and liabilities linked by agreement to changes in prices made in accordance with paragraph 31.7 against the gain or loss on net monetary position.

Economies ceasing to be hyperinflationary

- 31.14 When an economy ceases to be hyperinflationary and an entity discontinues the preparation and presentation of financial statements prepared in accordance with this section, it shall treat the amounts expressed in the presentation currency at the end of the previous reporting period as the basis for the **carrying amounts** in its subsequent financial statements.

Disclosures

- 31.15 An entity to which this section applies shall disclose the following:
- (a) the fact that financial statements and other prior period data have been restated for changes in the general purchasing power of the functional currency.
 - (b) the identity and level of the price index at the reporting date and changes during the current reporting period and the previous reporting period.
 - (c) amount of gain or loss on monetary items.

SECTION 32

EVENTS AFTER THE END OF THE REPORTING PERIOD

Scope of this section

- 32.1 This section defines events after the end of the **reporting period** and sets out principles for recognising, measuring and disclosing those events.

Events after the end of the reporting period defined

- 32.2 Events after the end of the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. There are two types of events:
- (a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the end of the reporting period), and
 - (b) those that are indicative of conditions that arose after the end of the reporting period (non-adjusting events after the end of the reporting period).
- 32.3 Events after the end of the reporting period include all events up to the date when the financial statements are authorised for issue, even if those events occur after the public announcement of profit or loss of other selected financial information.

Recognition and measurement

Adjusting events after the end of the reporting period

- 32.4 An entity shall adjust the amounts recognised in its financial statements, including related disclosures, to reflect adjusting events after the end of the reporting period.
- 32.5 The following are examples of adjusting events after the end of the reporting period that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:
- (a) the settlement after the end of the reporting period of a court case that confirms that the entity had a present obligation at the end of the reporting period. The entity adjusts any previously recognised **provision** related to this court case in accordance with Section 21 *Provisions and Contingencies* or recognises a new provision. The entity does not merely disclose a contingent liability. Rather, the settlement provides additional evidence to be considered in determining the provision that should be recognised at the end of the reporting period in accordance with Section 21.
 - (b) the receipt of information after the end of the reporting period indicating that an asset was impaired at the end of the reporting period, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted. For example:
 - (i) the bankruptcy of a customer that occurs after the end of the reporting period usually confirms that a loss existed at the end of the reporting period on a trade receivable and that the entity needs to adjust the **carrying amount** of the trade receivable; and

- (ii) the sale of inventories after the end of the reporting period may give evidence about their selling price at the end of the reporting period for the purpose of assessing impairment at that date.
- (c) the determination after the end of the reporting period of the cost of assets purchased, or the proceeds from assets sold, before the end of the reporting period.
- (d) the determination after the end of the reporting period of the amount of profit-sharing or bonus payments, if the entity had a legal or **constructive obligation** at the end of the reporting period to make such payments as a result of events before that date (see Section 28 *Employee Benefits*).
- (e) the discovery of fraud or **errors** that show that the financial statements are incorrect.

Non-adjusting events after the end of the reporting period

- 32.6 An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the end of the reporting period.
- 32.7 Examples of non-adjusting events after the end of the reporting period include:
- (a) a decline in market value of investments between the end of the reporting period and the date when the financial statements are authorised for issue. The decline in market value does not normally relate to the condition of the investments at the end of the reporting period, but reflects circumstances that have arisen subsequently. Therefore, an entity does not adjust the amounts recognised in its financial statements for the investments. Similarly, the entity does not update the amounts disclosed for the investments as at the end of the reporting period, although it may need to give additional disclosure in accordance with paragraph 32.10.
 - (b) an amount that becomes receivable as a result of a favourable judgement or settlement of a court case after the **reporting date** but before the financial statements are issued. This would be a contingent asset at the reporting date (see paragraph 21.13), and disclosure may be required by paragraph 21.16. However, agreement on the amount of damages for a judgement that was reached before the reporting date, but was not previously recognised because the amount could not be measured reliably, may constitute an adjusting event.

Dividends

- 32.8 If an entity declares dividends to holders of its equity instruments after the end of the reporting period, the entity shall not recognise those dividends as a liability at the end of the reporting period. The amount of the dividend may be presented as a segregated component of retained earnings at the end of the reporting period.

Disclosure

Date of authorisation for issue

- 32.9 An entity shall disclose the date when the financial statements were authorised for issue and who gave that authorisation. If the entity's owners or others have the power to amend the financial statements after issue, the entity shall disclose that fact.

Non-adjusting events after the end of the reporting period

- 32.10 An entity shall disclose the following for each category of non-adjusting event after the end of the reporting period:
- (a) the nature of the event, and

(b) an estimate of its financial effect, or a statement that such an estimate cannot be made.

32.11 The following are examples of non-adjusting events after the end of the reporting period that would generally result in disclosure; the disclosures will reflect information that becomes known after the end of the reporting period but before the financial statements are authorised for issue:

- (a) a major business combination or disposal of a major subsidiary.
- (b) announcement of a plan to discontinue an operation.
- (c) major purchases of assets, disposals or plans to dispose of assets, or expropriation of major assets by government.
- (d) the destruction of a major production plant by a fire.
- (e) announcement, or commencement of the implementation, of a major restructuring.
- (f) issues or repurchases of an entity's debt or equity instruments.
- (g) abnormally large changes in asset prices or foreign exchange rates.
- (h) changes in tax rates or tax laws enacted or announced that have a significant effect on current and deferred tax assets and liabilities.
- (i) entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees.
- (j) commencement of major litigation arising solely out of events that occurred after the end of the reporting period.

SECTION 33

RELATED PARTY DISCLOSURES

Scope of this section

- 33.1 This section requires an entity to include in its financial statements the disclosures necessary to draw attention to the possibility that its **financial position** and profit or loss have been affected by the existence of **related parties** and by transactions and outstanding balances with such parties.
- 33.1A The requirements of this section need not be given for transactions entered into between two or more members of a group, provided that any subsidiary undertaking which is a party to the transaction are wholly-owned by such a member.

Related party defined

- 33.2 A related party is a person or entity that is related to the entity that is preparing its financial statements (the reporting entity).
- (a) A person or a close member of that person's family is related to a reporting entity if that person:
 - (i) has control or joint control over the reporting entity;
 - (ii) has significant influence over the reporting entity; or
 - (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.
 - (b) An entity is related to a reporting entity if any of the following conditions applies:
 - (i) the entity and the reporting entity are members of the same **group** (which means that each parent, subsidiary and fellow subsidiary is related to the others).
 - (ii) one entity is an associate or joint venture of the other entity (or of a member of a group of which the other entity is a member).
 - (iii) both entities are joint ventures of the same third party.
 - (iv) one entity is a joint venture of a third entity and the other entity is an associate of the third entity.
 - (v) the entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
 - (vi) the entity is controlled or jointly controlled by a person identified in (a).
 - (vii) a person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).
- 33.3 In considering each possible related party relationship, an entity shall assess the substance of the relationship and not merely the legal form.

33.4 In the context of this [draft] FRS, the following are not related parties:

- (a) two entities simply because they have a director or other member of key management personnel in common or because a member of key management personnel of one entity has significant influence over the other entity.
- (b) two **venturers** simply because they share **joint control** over a joint venture.
- (c) any of the following simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process):
 - (i) providers of finance.
 - (ii) trade unions.
 - (iii) public utilities.
 - (iv) government departments and agencies.
- (d) a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, merely by virtue of the resulting economic dependence.

33.4A In the definition of a related party, an associate includes subsidiaries of the associate and a joint venture includes subsidiaries of the joint venture. Therefore, for example, an associate's subsidiary and the investor that has significant influence over the associate are related to each other.

Disclosures

Disclosure of parent-subsidiary relationships

33.5 Relationships between a parent and its subsidiaries shall be disclosed irrespective of whether there have been related party transactions. An entity shall disclose the name of its parent and, if different, the ultimate controlling party. If neither the entity's parent nor the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent that does so (if any) shall also be disclosed.

Disclosure of key management personnel compensation

33.6 Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity. Compensation includes all employee benefits (as defined in Section 28 *Employee Benefits*) including those in the form of share-based payment (see Section 26 *Share-based Payment*). Employee benefits include all forms of consideration paid, payable or provided by the entity, or on behalf of the entity (eg by its parent or by a shareholder), in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of goods or services provided to the entity.

33.7 An entity shall disclose key management personnel compensation in total.

Disclosure of related party transactions

33.8 A **related party transaction** is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged. Examples of related party transactions that are common to entities within the scope of this [draft] FRS include, but are not limited to:

- (a) transactions between an entity and its principal owner(s).
- (b) transactions between an entity and another entity when both entities are under the common control of a single entity or person.
- (c) transactions in which an entity or person that controls the reporting entity incurs expenses directly that otherwise would have been borne by the reporting entity.

33.9 If an entity has related party transactions, it shall disclose the nature of the related party relationship as well as information about the transactions, outstanding balances and commitments necessary for an understanding of the potential effect of the relationship on the financial statements. Those disclosure requirements are in addition to the requirements in paragraph 33.7 to disclose key management personnel compensation. At a minimum, disclosures shall include:

- (a) the amount of the transactions.
- (b) the amount of outstanding balances and:
 - (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement, and
 - (ii) details of any guarantees given or received.
- (c) provisions for uncollectible receivables related to the amount of outstanding balances.
- (d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

Such transactions could include purchases, sales, or transfers of goods or services; leases; guarantees; and settlements by the entity on behalf of the related party or vice versa.

33.10 An entity shall make the disclosures required by paragraph 33.9 separately for each of the following categories:

- (a) entities with control, joint control or significant influence over the entity.
- (b) entities over which the entity has control, joint control or significant influence.
- (c) key management personnel of the entity or its parent (in the aggregate).
- (d) other related parties.

33.11 An entity is exempt from the disclosure requirements of paragraph 33.9 in relation to:

- (a) a **state** (a national, regional or local government) that has control, joint control or significant influence over the reporting entity, and
- (b) another entity that is a related party because the same state has control, joint control or significant influence over both the reporting entity and the other entity.

However, the entity must still disclose a parent-subsidiary relationship as required by paragraph 33.5.

- 33.12 The following are examples of transactions that shall be disclosed if they are with a related party:
- (a) purchases or sales of goods (finished or unfinished).
 - (b) purchases or sales of property and other assets.
 - (c) rendering or receiving of services.
 - (d) leases.
 - (e) transfers of research and development.
 - (f) transfers under licence agreements.
 - (g) transfers under finance arrangements (including loans and equity contributions in cash or in kind).
 - (h) provision of guarantees or collateral.
 - (i) settlement of liabilities on behalf of the entity or by the entity on behalf of another party.
 - (j) participation by a parent or subsidiary in a defined benefit plan that shares risks between group entities.
- 33.13 An entity shall not state that related party transactions were made on terms equivalent to those that prevail in arm's length transactions unless such terms can be substantiated.
- 33.14 An entity may disclose items of a similar nature in the aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity.

SECTION 34

SPECIALISED ACTIVITIES

Scope of this section

- 34.1 This section provides guidance on financial reporting by entities with the scope of this [draft] FRS involved in types of specialised activities.

Agriculture

- 34.2 An entity using this [draft] FRS that is engaged in **agricultural activity** shall determine its accounting policy for each class of its **biological assets** as follows:
- (a) The entity shall use the fair value model in paragraphs 34.4–34.7 for those biological assets for which **fair value** is readily determinable without undue cost or effort.
 - (b) The entity shall use the cost model in paragraphs 34.8–34.10 for all other biological assets.

Recognition

- 34.3 An entity shall recognise a biological asset or **agricultural produce** when, and only when:
- (a) the entity controls the asset as a result of past events;
 - (b) it is probable that future economic benefits associated with the asset will flow to the entity; and
 - (c) the **fair value** or cost of the asset can be measured reliably without undue cost or effort.

Measurement – fair value model

- 34.4 An entity shall measure a biological asset on initial recognition and at each **reporting date** at its fair value less costs to sell. Changes in fair value less costs to sell shall be recognised in profit or loss.
- 34.5 Agricultural produce harvested from an entity's biological assets shall be measured at its fair value less costs to sell at the point of harvest. Such measurement is the cost at that date when applying Section 13 *Inventories* or another applicable section of this [draft] FRS.
- 34.6 In determining fair value, an entity shall consider the following:
- (a) If an active market exists for a biological asset or agricultural produce in its present location and condition, the quoted price in that market is the appropriate basis for determining the fair value of that asset. If an entity has access to different active markets, the entity shall use the price existing in the market that it expects to use.
 - (b) If an active market does not exist, an entity uses one or more of the following, when available, in determining fair value:
 - (i) the most recent market transaction price, provided that there has not been a significant change in economic circumstances between the date of that transaction and the end of the reporting period;
 - (ii) market prices for similar assets with adjustment to reflect differences; and

- (iii) sector benchmarks such as the value of an orchard expressed per export tray, bushel, or hectare, and the value of cattle expressed per kilogram of meat.
- (c) In some cases, the information sources listed in (a) or (b) may suggest different conclusions as to the fair value of a biological asset or agricultural produce. An entity considers the reasons for those differences, to arrive at the most reliable estimate of fair value within a relatively narrow range of reasonable estimates.
- (d) In some circumstances, fair value may be readily determinable without undue cost or effort even though market determined prices or values are not available for a biological asset in its present condition. An entity shall consider whether the present value of expected net cash flows from the asset discounted at a current market determined rate results in a reliable measure of fair value.

Disclosures – fair value model

34.7 An entity shall disclose the following with respect to its biological assets measured at fair value:

- (a) a description of each class of its biological assets.
- (b) the methods and significant assumptions applied in determining the fair value of each category of agricultural produce at the point of harvest and each category of biological assets.
- (c) a reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the current period. The reconciliation shall include:
 - (i) the gain or loss arising from changes in fair value less costs to sell.
 - (ii) increases resulting from purchases.
 - (iii) decreases resulting from harvest.
 - (iv) increases resulting from business combinations.
 - (v) net exchange differences arising on the translation of financial statements into a different presentation currency, and on the translation of a foreign operation into the presentation currency of the reporting entity.
 - (vi) other changes.

Measurement – cost model

34.8 The entity shall measure at cost less any accumulated **depreciation** and any accumulated **impairment** losses those biological assets whose fair value is not readily determinable without undue cost or effort.

34.9 The entity shall measure agricultural produce harvested from its biological assets at fair value less estimated costs to sell at the point of harvest. Such measurement is the cost at that date when applying Section 13 or other sections of this [draft] FRS.

Disclosures – cost model

34.10 An entity shall disclose the following with respect to its biological assets measured using the cost model:

- (a) a description of each class of its biological assets.

- (b) an explanation of why fair value cannot be measured reliably.
- (c) the depreciation method used.
- (d) the useful lives or the depreciation rates used.
- (e) the gross **carrying amount** and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.

Extractive activities

- 34.11 An entity using this [draft] FRS that is engaged in the exploration for, evaluation or extraction of mineral resources (extractive activities) shall account for expenditure on the acquisition or development of tangible or intangible assets for use in extractive activities by applying Section 17 *Property, Plant and Equipment* and Section 18 *Intangible Assets other than Goodwill*, respectively. When an entity has an obligation to dismantle or remove an item, or to restore the site, such obligations and costs are accounted for in accordance with Section 17 and Section 21 *Provisions and Contingencies*.

Service concession arrangements

- 34.12 A service concession arrangement is an arrangement whereby a government or other public sector body (the grantor) contracts with a private operator to develop (or upgrade), operate and maintain the grantor's infrastructure assets such as roads, bridges, tunnels, airports, energy distribution networks, prisons or hospitals. In those arrangements, the grantor controls or regulates what services the operator must provide using the assets, to whom, and at what price, and also controls any significant residual interest in the assets at the end of the term of the arrangement.
- 34.13 There are two principal categories of service concession arrangements:
- (a) In one, the operator receives a financial asset – an unconditional contractual right to receive a specified or determinable amount of cash or another financial asset from the government in return for constructing or upgrading a public sector asset, and then operating and maintaining the asset for a specified period of time. This category includes guarantees by the government to pay for any shortfall between amounts received from users of the public service and specified or determinable amounts.
 - (b) In the other, the operator receives an intangible asset – a right to charge for use of a public sector asset that it constructs or upgrades and then operates and maintains for a specified period of time. A right to charge users is not an unconditional right to receive cash because the amounts are contingent on the extent to which the public uses the service.

Sometimes, a single contract may contain both types: to the extent that the government has given an unconditional guarantee of payment for the construction of the public sector asset, the operator has a financial asset; to the extent that the operator has to rely on the public using the service in order to obtain payment, the operator has an intangible asset.

Accounting – financial asset model

- 34.14 The operator shall recognise a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services. The operator shall measure the financial asset at fair value. Thereafter, it shall follow Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues* in accounting for the financial asset.

Accounting – intangible asset model

- 34.15 The operator shall recognise an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. The operator shall initially measure the intangible asset at fair value. Thereafter, it shall follow Section 18 in accounting for the intangible asset.

Operating revenue

- 34.16 The operator of a service concession arrangement shall recognise, measure and disclose revenue in accordance with Section 23 *Revenue* for the services it performs.

Financial Institutions: Disclosures

- 34.17 A **financial institution**, applying this [draft] FRS shall, in addition to the disclosure requirements in Sections 11 and Section 12, provide the disclosures in paragraphs 34.18 to 34.30.

- 34.18 A financial institution is either:

- (a) a bank which is:
 - (i) a firm with a Part IV permission* which includes accepting deposits; and:
 - a. which is a credit institution; or
 - b. whose Part IV permission includes a requirement that it complies with the rules in the General Prudential sourcebook and the Prudential sourcebook for Banks, Building Societies and Investment Firms relating to banks, but which is not a building society, a friendly society or a credit union; or
 - (ii) an EEA bank which is a full credit institution; or
- (b) a building society which is defined in section 119(1) of the Building Societies Act 1986 as a building society incorporated (or deemed to be incorporated) under that Act; or
- (c) an entity that undertakes the business of effecting or carrying out insurance contracts, including general and life assurance entities; or
- (d) an investment trust, Irish Investment Company[†], venture capital trust, mutual fund, exchange traded fund, unit trust, open-ended investment company (OEIC), custodian bank or stockbroker; or
- (e) a credit union, being a body corporate registered under the Industrial and Provident Societies Act 1965 as a credit union in accordance with the Credit Unions Act 1979, which is an authorised person; or
- (f) an incorporated friendly society or a registered friendly society; or
- (g) a **retirement benefit plan**.

* As defined in section 40(4) of the Financial Services and Markets Act 2000.

† An Investment Company is a corporate vehicle formed under section 47(3) of the Companies (Amendment) Act 1983 and section 58 of the Companies (Amendment) Act 1986, and regulated by the Irish Financial Regulator.

Significance of financial instruments for financial position and performance

- 34.19 A financial institution shall disclose information that enables users of its financial statements to evaluate the significance of **financial instruments** for its financial position and performance.
- 34.20 A financial institution shall disclose a disaggregation of the statement of financial position line item by class of financial instrument. A class is a grouping of financial instruments that is appropriate to the nature of the information disclosed and that takes into account the characteristics of those financial instruments.

Impairment

- 34.21 Where a financial institution uses a separate allowance account to record impairment, it shall disclose a reconciliation of changes in that account during the period for each class of **financial assets**.

Fair Value

- 34.22 A financial institution shall disclose an analysis of financial instruments held at fair value on the statement of financial position using the hierarchy in paragraph 11.27.

Nature and extent of risks arising from financial instruments

- 34.23 A financial institution shall disclose information that enables users of its financial statements to evaluate the nature and extent of **credit, liquidity** and **market risks** arising from financial instruments to which the financial institution is exposed at the end of the reporting period.
- 34.24 For each type of risk arising from financial instruments, a financial institution 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.

Credit risk

- 34.25 A financial institution 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. 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 of other credit enhancements, and the extent to which these mitigate credit risk;
 - (c) the amount by which any related credit **derivatives** or similar instruments mitigate that maximum exposure to credit risk; and
 - (d) information about the credit quality of financial assets that are neither past due nor impaired.
- 34.26 A financial institution shall provide a maturity analysis, by class of financial asset, for financial assets that are:
- (a) past due as at the end of the reporting period but not impaired; and

- (b) individually determined to be impaired as at the end of the reporting period, including the factors the financial institution considered in determining that they are impaired.

34.27 When the financial institution obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (eg guarantees), and such assets meet the recognition criteria in other sections, the financial institution shall disclose:

- (a) the nature and carrying amount of the assets obtained; 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

34.28 A financial institution shall provide a maturity analysis for **financial liabilities** that shows the remaining contractual maturities at undiscounted amounts separated between derivative and non-derivative financial liabilities.

Market risk

34.29 A financial institution shall provide a sensitivity analysis for each type of market risk (eg interest rate risk, currency risk, other price risk) a financial institution is exposed to, showing the impact on profit and loss and equity. Details of the methods and assumptions used should be provided.

34.30 If the financial institution prepares a sensitivity analysis, such as value-at-risk, that reflects interdependencies between risk variables (eg interest rates and exchange rates) and uses it to manage financial risks, it may use that sensitivity analysis instead.

Retirement Benefit Plans: Financial Statements

Defined contribution plans

34.31 A retirement benefit plan applying this [draft] FRS shall, in addition apply the requirements of paragraphs 34.32 to 34.46 in the financial statements of the retirement benefit plan.

34.32 The objective of reporting by a **defined contribution plan** is periodically to provide information about the plan and the performance of its investments. That objective is usually achieved by providing the following, either as part of the financial statements, or alongside the financial statements:

- (a) a description of significant activities for the period and the effect of any changes relating to the plan, and its membership and terms and conditions;
- (b) statements reporting on the transactions and investment performance for the period and the financial position of the plan at the end of the period; and
- (c) a description of the investment strategies.

34.33 The financial statements of a defined contribution plan shall contain as part of the financial statements:

- (a) a statement of changes in net assets available for benefits (which can also be called a Fund Account); and
- (b) a statement of net assets available for benefits.

- 34.34 A description of the funding policy shall be presented either, as part of the financial statements, or alongside the financial statements.

Defined benefit plans

- 34.35 The objective of reporting by a **defined benefit plan** is periodically to provide information about the financial resources and activities of the plan that is useful in assessing the relationships between the accumulation of resources and plan benefits over time. This objective is usually achieved by providing the following, either as part of the financial statements, or alongside the financial statements:
- (a) a description of significant activities for the period and the effect of any changes relating to the plan, and its membership and terms and conditions;
 - (b) statements reporting on the transactions and investment performance for the period and the financial position of the plan at the end of the period;
 - (c) actuarial information; and
 - (d) a description of the investment strategies.
- 34.36 The financial statements of a defined benefit plan shall contain as part of the financial statements:
- (a) a statement of changes in net assets available for benefits (which can also be called a Fund Account); and
 - (b) a statement of net assets available for benefits.
- 34.37 Information regarding the actuarial present value of promised retirement benefits shall be presented either, as part of the financial statements, or alongside the financial statements.
- 34.38 The financial statements may be presented alongside a trustees' report in the nature of a management or directors' report and an investment report. This [draft] FRS permits disclosure of the actuarial information and the description of the investment strategies either as part of the financial statements or presented alongside the trustees report.
- 34.39 At each reporting date the **net assets available for benefits** shall be measured at fair value using the guidance in paragraphs 11.27 – 11.32 Changes in fair value shall be recognised in profit or loss or the Fund Account.

Statement of net assets available for benefits

- 34.40 The financial statements of a retirement benefit plan, whether defined contribution or defined benefit, shall present the following in the statement of net assets available for benefits:
- (a) assets at the end of the period suitably classified;
 - (b) the basis of valuation of assets;
 - (c) details of any single investment exceeding either 5% of the net assets available for benefits or 5% of any class or type of security;
 - (d) details of any investment in the employer; and
 - (e) liabilities other than the actuarial present value of promised retirement benefits.

Statement of changes in net assets available for benefits (Fund Account)

34.41 The financial statements of a retirement benefit plan, whether defined contribution or defined benefit, shall present the following in the statement of changes in net assets available for benefits:

- (a) employer contributions;
- (b) employee contributions;
- (c) investment income such as interest and dividends;
- (d) other income;
- (e) benefits paid or payable (analysed, for example, as retirement, death and disability benefits, and lump sum payments);
- (f) administrative expenses;
- (g) other expenses;
- (h) taxes on income;
- (i) profits and losses on disposal of investments and changes in value of investments; and
- (j) transfers from and to other plans.

Disclosure

34.42 A retirement benefit plan, whether defined contribution or defined benefit shall make the disclosures required by paragraphs 34.17 to 34.30 of this [draft] FRS.

34.43 A defined benefit plan shall disclose information regarding the actuarial present value of promised retirement benefits including:

- (a) the actuarial present value of promised retirement benefits, distinguishing between vested and non-vested benefits. The actuarial present value of promised retirement benefits shall be based on the most recent valuation which is prepared by the trustees.
- (b) the technical provisions ie the amount required to meet the actuarial liabilities and the actuarial estimate of the solvency of the plan.
- (c) the significant actuarial assumptions made and the method used to calculate the actuarial present value of promised retirement benefits.

34.44 The actuarial information required by paragraph 34.42 shall be:

- (a) based on the most recent valuation; and
- (b) the date of the valuation shall be disclosed.

34.45 A retirement benefit plan shall disclose, either as part of the financial statements or alongside the financial statements, a description of its funding policy. The disclosure shall explain how the promised retirement benefits will be met through the investment strategy and funding policy.

- 34.46 The annual report of a retirement benefit plan contains a description of the plan, either as part of the financial statements or in a separate report. It may contain the following:
- (a) the names of the employers and the employee groups covered;
 - (b) the number of participants receiving benefits and the number of other participants, classified as appropriate;
 - (c) the type of plan – defined contribution or defined benefit;
 - (d) a note as to whether participants contribute to the plan;
 - (e) a description of the retirement benefits promised to participants;
 - (f) a description of any plan termination terms; and
 - (g) changes in items (a) to (f) during the period covered by the report.

Heritage assets

- 34.47 All **heritage assets** shall be accounted for in accordance with the requirements of paragraphs 34.47 to 34.53. These paragraphs do not apply to other categories of asset such as **investment property** or **property, plant and equipment**.
- 34.48 Works of art and similar objects are sometimes held by commercial entities but are not heritage assets because they are not maintained principally for their contribution to knowledge and culture. These assets shall therefore be accounted for in accordance with Section 17. Historic assets used by the entity itself, for example historical buildings used for teaching by education establishments, shall also be accounted for in accordance with Section 17. This is based on the view that an operational perspective is likely to be most relevant for most users of financial statements. However, entities that use historical buildings and similar assets may wish to consider whether it might be appropriate to apply the disclosures required by paragraphs 34.52 and 34.53.

Recognition and measurement

- 34.49 An entity shall recognise and measure heritage assets in accordance with Section 17 (ie using the cost model or revaluation model), subject to the requirements set out in paragraphs 34.49 to 34.51 below.
- 34.50 Heritage assets shall be recognised in the **statement of financial position** separately from other assets.
- 34.51 Where heritage assets have previously been capitalised or are recently purchased, information on the cost or value of the asset will be available. Where this information is not available, and cannot be obtained at a cost which is commensurate with the benefits to users of the **financial statements**, the assets shall not be recognised in the statement of financial position, but must be disclosed in accordance with the requirements below.
- 34.52 At each reporting date, an entity shall apply Section 27 *Impairment of Assets* to determine whether a heritage asset is impaired and, if so, how to recognise and measure the **impairment loss**. A heritage asset may be impaired, for example where it has suffered physical deterioration or breakage or new doubts arise as to its authenticity.

Disclosure

34.53 An entity shall disclose the following for all heritage assets it holds:

- (a) An indication of the nature and scale of heritage assets held by the entity.
- (b) The policy for the acquisition, preservation, management and disposal of heritage assets (including a description of the records maintained by the entity of its collection of heritage assets and information on the extent to which access to the assets is permitted).
- (c) The **accounting policies** adopted for heritage assets, including details of the measurement bases used.
- (d) For heritage assets that have not been recognised in the statement of financial position, the **notes** to the financial statements shall:
 - (i) explain the reasons why;
 - (ii) describe the significance and nature of those assets; and
 - (iii) disclose information that is helpful in assessing the value of those heritage assets.
- (e) Where heritage assets are recognised in the statement of financial position the following disclosure is required:
 - (i) the carrying amount of heritage assets at the beginning of the **reporting period** and the **reporting date**, including an analysis between classes or groups of heritage assets recognised at cost and those recognised at valuation; and
 - (ii) where assets are recognised at valuation, sufficient information to assist in understanding the valuation being recognised (date of valuation, method used, whether carried out by external valuer and if so their qualification and any significant limitations on the valuation).
- (f) A summary of transactions relating to heritage assets for the reporting period and each of the previous four reporting periods disclosing:
 - (i) the cost of acquisitions of heritage assets;
 - (ii) the value of heritage assets acquired by donations;
 - (iii) the carrying amount of heritage assets disposed of in the period and proceeds received; and
 - (iv) any impairment recognised in the period.

The summary shall show separately those transactions included in the statement of financial position and those that are not.

- (g) In exceptional circumstances where it is not practicable to obtain a valuation of heritage assets acquired by donation the reason shall be stated.

Disclosures can be aggregated for groups or classes of heritage assets, provided this does not obscure significant information.

34.54 The disclosures required by paragraph 34.53(f) need not be given for any accounting period earlier than the period immediately before the period in which this [draft] FRS is first applied where it is not practicable to do so and a statement to the effect that it is not practicable is made.

Funding commitments

- 34.55 An entity that commits to provide resources to other entities shall apply the requirements of paragraphs 34.55 to 34.61 and the accompanying guidance.
- 34.56 When applying these paragraphs, the requirements of Section 2 *Concepts and pervasive principles* and Section 21 shall also be taken into consideration.

Recognition

- 34.57 An entity shall recognise a liability, where it has made a commitment that it will provide resources to another party, if, and only if:
- (a) the obligation (which may be constructive) is such that the entity cannot realistically withdraw from it; and
 - (b) the entitlement of the other party to the resources does not depend on the satisfaction of performance conditions.
- 34.58 Commitments made which are performance-related will be recognised when those **performance conditions** are met.

Measurement

- 34.59 An entity shall measure any recognised liability at the present value of the resources committed.

Disclosure

- 34.60 An entity that has made a commitment shall disclose the following:
- (a) the commitment made;
 - (b) the time-frame of that commitment;
 - (c) any performance-related conditions attached to that commitment; and
 - (d) details of how that commitment will be funded.
- 34.61 The above disclosures may be made in aggregate, providing that such aggregation does not obscure significant information. However, separate disclosure shall be made for recognised and unrecognised commitments.

Incoming resources from non-exchange transactions

- PBE34.62 The accounting for **grants** is addressed in the Section 24 *Grants*.
- PBE34.63 Paragraphs PBE34.64 to PBE34.73 applies to other resources received from **non-exchange transactions**. A non-exchange transaction is a transaction whereby an entity receives value from another entity without directly giving approximately equal value in exchange or gives value to another entity without directly receiving approximately equal value in exchange.
- PBE34.64 Non-exchange transactions include, but are not limited to, donations (of cash, goods, and services) and legacies.

Recognition and measurement

- PBE34.65 An entity shall recognise receipts of resources from non-exchange transactions as follows:

- (a) transactions that do not impose specified future performance conditions on the recipient are recognised in income when the resources are receivable.
- (b) transactions that do impose specified future performance conditions on the recipient are recognised in income only when the performance conditions are met.
- (c) where resources are received before the revenue recognition criteria are satisfied a liability is recognised.

PBE34.66 The existence of a **restriction** does not prohibit a resource from being recognised in income when receivable.

PBE34.67 When applying the requirements of paragraph PBE34.65, an entity must take into consideration whether the resource can be measured reliably and whether the benefits to recognise the resource outweigh the costs.

PBE34.68 Therefore, where it is not practicable to estimate the value of the resources with sufficient reliability or benefit, the income shall be included in the financial period when the resources are sold or distributed.

PBE34.69 An entity shall recognise a liability for any resource with specified performance conditions that becomes repayable due to non-compliance with the performance conditions, when that repayment becomes **probable**.

PBE34.70 Donations of services that can be reasonably quantified will usually result in the recognition of income and an expense. An asset will be recognised only when those services are used for the production of an asset, and the services received will be capitalised as part of the cost of that asset.

PBE34.71 An entity shall measure resources from non-exchange transactions at the fair value of the resources received or receivable.

Disclosure

PBE34.72 An entity shall disclose the following:

- (a) the nature and amounts of resources receivable from non-exchange transactions recognised in the financial statements;
- (b) any unfulfilled conditions or other contingencies attaching to resources from non-exchange transactions that have not been recognised in income; and
- (c) an indication of other forms of resources from non-exchange transactions from which the entity has benefited.

Public Benefit Entity Combinations

PBE34.73 Paragraphs PBE34.73 to PBE34.86 applies only to **public benefit entities** for the following categories of **entity combinations** which involve a whole entity or parts of an entity combining with another entity:

- (a) combinations at nil or nominal consideration which are in substance a gift; and
- (b) combinations which meet the definition and criteria of a **merger**.

PBE34.74 Combinations which are determined to be acquisitions shall be accounted for in accordance with Section 19 *Business Combinations* of this [draft] FRS.

Combinations that are in substance a gift

Definition

PBE34.75 A combination carried out at nil or nominal consideration that is not a fair value exchange but in substance the gift of one entity to another.

Accounting

PBE34.76 A combination that is in substance a gift shall be accounted for in accordance with Section 19 of this [draft] FRS except for the matters addressed in paragraphs PBE34.77 and PBE34.78 below.

PBE34.77 The excess of the fair value of the assets received over the fair value of the liabilities assumed is recognised as a gain. This gain represents the gift of the value of one entity to another and shall be recognised as income.

PBE34.78 The excess of the fair value of the liabilities assumed over the fair value of the assets received is recognised as a loss. This loss represents the net obligations assumed, for which the receiving entity has not received a financial reward. This loss shall be recognised as an expense.

Combinations that are a merger

Definition and criteria

PBE34.79 A merger is an entity combination that results in the creation of a new reporting entity formed from the combining parties, in which the controlling parties of the combining entities come together in a partnership for the mutual sharing of risks and benefits of the newly formed entity and in which no party to the combination in substance obtains control over any other, or is otherwise seen to be dominant.

PBE34.80 All of the following criteria must be met for an entity combination to meet the definition of a merger:

- (a) no party to the combination is portrayed as either acquirer or acquiree, either by its own board or management or by that of another party to the combination;
- (b) there is no significant change to the classes of beneficiaries of the combining entities or the purpose of the benefits provided as a result of the combination; and
- (c) all parties to the combination, as represented by the members of the board, participate in establishing the management structure of the combined entity and in selecting the management personnel, and such decisions are made on the basis of a consensus between the parties to the combination rather than purely by exercise of voting rights.

PBE34.81 Entity combinations that meet all of the three criteria set out in paragraph PBE34.80(a) to (c) shall apply merger accounting as prescribed below.

PBE34.82 Any entity combination which does not meet all of the three criteria set out in paragraph PBE34.80(a) to (c) shall be accounted for as an acquisition in accordance with Section 19.

Accounting

PBE34.83 Under merger accounting the carrying value of the assets and liabilities of the parties to the combination are not adjusted to fair value, although adjustments should be made to achieve uniformity of accounting policies across the combining entities.

PBE34.84 The results and **cash flows** of all the combining entities shall be brought into the financial statements of the newly formed entity from the beginning of the financial period in which the merger occurs.

PBE34.85 The corresponding figures should be restated by including the results for all the combining entities for the previous accounting period and their statement of financial positions for the previous reporting date. The comparative figures should be marked as 'combined' figures.

PBE34.86 All costs associated with the merger shall be charged to **income and expenditure**.

Disclosure

PBE34.87 For each business combination accounted for as a merger in the reporting period the following shall be disclosed in the newly formed entity's financial statements:

- (a) the names and descriptions of the combining entities or business;
- (b) the date of the merger;
- (c) an analysis of the principal components of the current year's primary financial statements to indicate:
 - (i) the amounts relating to the newly formed merged entity for the period after the date of the merger; and
 - (ii) the amounts relating to each party to the merger up to the date of the merger.
- (d) an analysis of the previous year's primary financial statements between each party to the merger;
- (e) the aggregate carrying value of the net assets of each party to the merger at the date of the merger; and
- (f) the nature and amount of any significant adjustments required to align accounting policies and an explanation of any further adjustments made to net assets as a result of the merger.

Concessionary Loans

PBE34.88 Paragraphs PBE34.88 to PBE34.98 address the recognition, measurement and disclosure of **concessionary loan** arrangements within the financial statements of public benefit entities (PBEs) making and receiving concessionary loans. These paragraphs apply to concessionary loan arrangements only and are not applicable to loans which are at a market rate or to other commercial arrangements.

PBE34.89 Concessionary loans are loans made or received between a PBE and a third party at below the **prevailing market rate** of interest that are not repayable on demand.

Accounting treatment

PBE34.90 PBEs making or receiving concessionary loans shall use either:

- (a) the recognition, measurement and disclosure requirements in Section 11, which requires initial measurement at fair value and subsequent measurement at **amortised cost** using the **effective interest method**; or
- (b) the accounting treatment set out in paragraphs PBE34.91 to PBE34.98 below.

A PBE shall apply the same accounting policy to concessionary loans both made and received.

Recognition and measurement

PBE34.91 A PBE making or receiving concessionary loans (as per paragraph PBE34.90(b)) to a third party shall initially measure these arrangements at the amount received or paid and recognise them in the statement of financial position.

Subsequent measurement

PBE34.92 In subsequent years the **carrying amount** of concessionary loans in the financial statements shall be adjusted to reflect accrued interest payable or receivable.

PBE34.93 To the extent that a loan has been made is irrecoverable an impairment loss shall be recognised in income and expenditure.

Presentation and disclosure

PBE34.94 The entity shall present concessionary loans either as a separate line item on the face of the statement of financial position or in the notes to the financial statements.

PBE34.95 Concessionary loans shall be classified separately to disclose amounts repayable within one year and amounts repayable in more than one year.

PBE34.96 The entity shall disclosure in the summary of significant accounting policies the measurement basis used for concessionary loans and any other accounting policies which are relevant to understanding these transactions within the financial statements.

PBE34.97 The entity shall also disclose the following information relating to concessionary loans:

- (a) the terms and conditions of concessionary loan arrangements, for example the interest rate, any security provided and the terms of the repayment; and
- (b) the value of concessionary loans which have been committed but not taken up at the year end.

PBE34.98 Concessionary loans made or received shall be disclosed separately, however multiple loans received or made may be disclosed in aggregate, providing that such aggregation does not obscure significant information.

APPENDIX I TO SECTION 34

GUIDANCE ON FUNDING COMMITMENTS

(paragraphs 34.55–34.61)

This guidance is an integral part of the [draft] Standard.

- 34A.1 Entities often make commitments to provide cash or other resources to other entities. In such a case, it is necessary to determine whether the commitment should be recognised as a liability. The definition of a liability requires that there be a present obligation, and not merely an expectation of a future outflow.
- 34A.2 A general statement that the entity intends to provide resources to certain classes of potential beneficiaries in accordance with its objectives does not in itself give rise to a liability, as the entity may amend or withdraw its policy, and potential beneficiaries do not have the ability to insist on their fulfilment. Similarly, a promise to provide cash conditional on the receipt of future income does not give rise to a liability as the entity cannot be required to fulfil it if the future income is not received.
- 34A.3 A liability is recognised only for a commitment that gives the recipient a valid expectation that payment will be made and from which the grantor cannot realistically withdraw. One of the implications of this is that a liability only exists where the commitment has been communicated to the recipient.
- 34A.4 Commitments are not recognised if they are subject to performance-related conditions. In such a case, the entity is required to fulfil its commitment only when the performance-related conditions are met, and no liability exists until that time.
- 34A.5 A commitment may contain conditions that are not performance-related conditions. For example, a requirement to provide an annual financial report to the grantor may serve mainly an administrative purpose because failure to comply would not release the grantor from its commitment. This may be distinguished from a requirement to submit a detailed report for review and consideration by the grantor of how funds will be utilised in order to secure payment. A mere restriction on the specific purpose for which funds are to be used does not in itself constitute a performance-related condition.
- 34A.6 Because many commitments are not recognised, it is important that full and informative disclosure is also made of the existence and sources of funding for unrecognised commitments

APPENDIX II TO SECTION 34

GUIDANCE ON INCOMING RESOURCES FROM NON-EXCHANGE TRANSACTIONS (PARAGRAPHS PBE34.62-PBE34.71)

This guidance is an integral part of the [draft] Standard.

Recognition

- PBE34B.1 The receipt of resources will usually result in an entity recognising an asset and corresponding income for the fair value of resources when those resources become received or receivable. Instances when this may differ include when:
- (a) an entity received those resources in the form of services (see PBE34B.8 to PBE34B.12); or
 - (b) there are performance conditions attached to the resources, which have yet to be fulfilled (see 34B.13- 34B.14).
- PBE34B.2 Resources should only be recognised when the fair value of the incoming resources can be measured reliably.
- PBE34B.3 The concepts of materiality (see paragraph 2.6), and cost/benefit (see paragraph 2.13) should be considered when deciding which resources received should be recognised in the financial statements.
- PBE34B.4 When it is impractical to recognise resources from non-exchange transactions (paragraph PBE34B.2 and PBE34B.3), the income is recognised in the period in which the resources are sold or distributed. The most common example is that of high volume, low value second-hand goods donated for resale.

Legacies

- PBE34B.5 Donations in the form of legacies are recognised when it is probable that the legacy will be received and its value can be measured reliably. These criteria will normally be met following probate once the executor(s) of the estate has established that there are sufficient assets in the estate, after settling liabilities, to pay the legacy.
- PBE34B.6 Evidence that the executor(s) has determined that a payment can be made may arise on the agreement of the estate's accounts or notification that payment will be made. Where notification is received after the year-end but it is clear that the executor(s) has agreed prior to the year-end that the legacy can be paid, the legacy is accrued in the financial statements. The certainty and measurability of the receipt may be affected by subsequent events such as valuations and disputes.
- PBE34B.7 Entities that are in receipt of numerous immaterial legacies for which individual identification would be burdensome, a portfolio approach may be taken.

Services

- PBE34B.8 Donated services that can be reasonably quantified should be recognised in the financial statements when they are received.
- PBE34B.9 Donated services that are consumed immediately are usually recognised as an expense. However, there may be circumstances when a service is used in the production of an asset, for example erecting a building. In these cases, the associated donated service (eg plumbing and electrical services) would be recognised as a part of the cost of that asset.

- PBE34B.10 Donated services that can be reasonably quantified include donated facilities (such as office accommodation; those services that would otherwise have been purchased; and those services usually provided by an individual or an entity as part of their trade or profession for a fee).
- PBE34B.11 It is not expected that contributions made by volunteers can be reasonably quantified, therefore these services shall not be recognised.
- PBE34B.12 Paragraph PBE34.72(c) requires an entity to disclose other forms of resources from non-exchange transactions from which the entity has benefited. This will include the disclosure of unrecognised volunteer services.

Performance Conditions

- PBE34B.13 Some resources are given with performance conditions attached which require the recipient to use the resources for a particular purpose in order to be entitled to retain the resources. An entity will not recognise income from those resources until these performance conditions have been met.
- PBE34B.14 However, some requirements are stated so broadly that they do not actually impose a performance condition on the recipient. In these cases the recipient will recognise income on receipt of the transfer of resources.

Measurement

- PBE34B.15 Paragraph PBE34.71 requires resources received to be measured at their fair value. These fair values are usually the price that the entity would have to pay on the open market for an equivalent item.
- PBE34B.16 When there is no direct evidence of an open market value for an equivalent item a value may be derived from sources such as:
- (a) the cost of the item to the donor; or
 - (b) in the case of goods that are expected to be sold, the estimated resale value (which may reflect the amount actually realised) after deducting the cost to sell the goods.
- PBE34B.17 Donations of services that are recognised should be measured at the estimated value of the service received. Donated services are recognised as income, and an equivalent amount shall be recognised as an expense in income and expenditure, unless the expense can be capitalised as part of the cost of an asset.

SECTION 35

TRANSITION TO THIS [DRAFT] FRS

Scope of this section

- 35.1 This section applies to a **first-time adopter of this [draft] FRS**, regardless of whether its previous accounting framework was **EU-adopted IFRS** or another set of generally accepted accounting principles (GAAP) such as its national accounting standards, or another framework such as the local income tax basis.
- 35.2 An entity can be a first-time adopter of this [draft] FRS only once. If an entity using this [draft] FRS stops using it for one or more **reporting periods** and then is required, or chooses, to adopt it again later, the special exemptions, simplifications and other requirements in this section do not apply to the re-adoption.

First-time adoption

- 35.3 A first-time adopter of this [draft] FRS shall apply this section in its first **financial statements** that conform to this [draft] FRS.
- 35.4 An entity's first financial statements that conform to this [draft] FRS are the first annual financial statements in which the entity makes an explicit and unreserved statement in those financial statements of compliance with this [draft] FRS. Financial statements prepared in accordance with this [draft] FRS are an entity's first such financial statements if, for example, the entity:
- (a) did not present financial statements for previous periods;
 - (b) presented its most recent previous financial statements under national requirements that are not consistent with this [draft] FRS in all respects; or
 - (c) presented its most recent previous financial statements in conformity with EU-adopted IFRS.
- 35.5 Paragraph 3.17 of this [draft] FRS defines a complete set of financial statements.
- 35.6 Paragraph 3.14 requires an entity to disclose, in a complete set of financial statements, comparative information in respect of the previous comparable period for all monetary amounts presented in the financial statements, as well as specified comparative narrative and descriptive information. An entity may present comparative information in respect of more than one comparable prior period. Therefore, an entity's **date of transition to this [draft] FRS** is the beginning of the earliest period for which the entity presents full comparative information in accordance with this [draft] FRS in its first financial statements that conform to this [draft] FRS.

Procedures for preparing financial statements at the date of transition

- 35.7 Except as provided in paragraphs 35.9–35.11, an entity shall, in its opening statement of financial position as of its date of transition to this [draft] FRS (ie the beginning of the earliest period presented):
- (a) recognise all assets and liabilities whose recognition is required by this [draft] FRS;

- (b) not recognise items as assets or liabilities if this [draft] FRS does not permit such recognition;
 - (c) reclassify items that it recognised under its previous financial reporting framework as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under this [draft] FRS; and
 - (d) apply this [draft] FRS in measuring all recognised assets and liabilities.
- 35.8 The **accounting policies** that an entity uses in its opening statement of financial position under this [draft] FRS may differ from those that it used for the same date using its previous financial reporting framework. The resulting adjustments arise from transactions, other events or conditions before the date of transition to this [draft] FRS. Therefore, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to this [draft] FRS.
- 35.9 On first-time adoption of this [draft] FRS, an entity shall not retrospectively change the accounting that it followed under its previous financial reporting framework for any of the following transactions:
- (a) **derecognition** of financial assets and financial liabilities. Financial assets and liabilities derecognised under an entity's previous accounting framework before the date of transition should not be recognised upon adoption of this [draft] FRS. Conversely, for financial assets and liabilities that would have been derecognised under this [draft] FRS in a transaction that took place before the date of transition, but that were not derecognised under an entity's previous accounting framework, an entity may choose (a) to derecognise them on adoption of this [draft] FRS or (b) to continue to recognise them until disposed of or settled.
 - (b) hedge accounting. An entity shall not change its hedge accounting before the date of transition to this [draft] FRS for the hedging relationships that no longer exist at the date of transition. For hedging relationships that exist at the date of transition, the entity shall follow the hedge accounting requirements of Section 12 *Other Financial Instruments Issues*, including the requirements for discontinuing hedge accounting for hedging relationships that do not meet the conditions of Section 12.
 - (c) accounting estimates.
 - (d) **discontinued operations**.
 - (e) measuring **non-controlling interests**. The requirements of paragraph 5.6 to allocate profit or loss and total comprehensive income between non-controlling interest and **owners** of the parent shall be applied prospectively from the date of transition to this [draft] FRS (or from such earlier date as this [draft] FRS is applied to restate business combinations—see paragraph 35.10).
- 35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this [draft] FRS:
- (a) ***Business combinations, including combination of entities or business combinations under common control***. A first-time adopter may elect not to apply Section 19 *Business Combinations and Goodwill* to business combinations that were effected before the date of transition to this [draft] FRS. However, if a first-time adopter restates any business combination to comply with Section 19, it shall restate all later business combinations.
 - (b) ***Share-based payment transactions***. A first-time adopter is not required to apply Section 26 *Share-based Payment* to equity instruments that were granted before the date of transition to this [draft] FRS, or to liabilities arising from share-based payment transactions that were

settled before the date of transition to this [draft] FRS. A first-time adopter, previously applying FRS 20 'Share-based Payment' is prohibited from making any amendment on transition to this FRS for share-based payment transactions.

- (c) **Fair value as deemed cost.** A first-time adopter may elect to measure an item of property, plant and equipment, an investment property, or an intangible asset which meets recognition criteria in Section 18 and the criteria in Section 18 for revaluation on the date of transition to this [draft] FRS at its fair value and use that fair value as its deemed cost at that date.
- (d) **Revaluation as deemed cost.** A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment, an investment property, or an intangible asset at, or before, the date of transition to this [draft] FRS as its deemed cost at the revaluation date.
- (e) **Cumulative translation differences.** Section 30 *Foreign Currency Translation* requires an entity to classify some translation differences as a separate component of equity. A first-time adopter may elect to deem the cumulative translation differences for all foreign operations to be zero at the date of transition to this [draft] FRS (ie a 'fresh start').
- (f) **Separate financial statements.** When an entity prepares **separate financial statements**, paragraph 9.26 requires it to account for its investments in subsidiaries, associates, and jointly controlled entities either:
 - (i) at cost less impairment
 - (ii) at **fair value** with changes in fair value recognised in accordance with paragraphs 17.15E and 17.15F, or
 - (iii) at **fair value** with changes in fair value recognised in profit or loss.

If a first-time adopter measures such an investment at cost, it shall measure that investment at one of the following amounts in its separate opening statement of financial position prepared in accordance with this [draft] FRS:

 - (i) cost determined in accordance with Section 9 *Consolidated and Separate Financial Statements*, or
 - (ii) deemed cost, which shall be previous GAAP carrying amount on that date.
- (g) **Compound financial instruments.** Paragraph 22.13 requires an entity to split a compound financial instrument into its liability and equity components at the date of issue. A first-time adopter need not separate those two components if the liability component is not outstanding at the date of transition to this [draft] FRS.
- (h) **Deferred income tax.** A first-time adopter is not required to recognise, at the date of transition to this [draft] FRS, **deferred tax assets** or **deferred tax liabilities** relating to differences between the **tax basis** and the **carrying amount** of any assets or liabilities for which recognition of those deferred tax assets or liabilities would involve undue cost or effort.
- (i) **Service concession arrangements.** A first-time adopter is not required to apply paragraphs 34.12–34.16 to service concession arrangements entered into before the date of transition to this [draft] FRS.
- (j) **Extractive activities.** A first-time adopter using full cost accounting under previous GAAP may elect to measure oil and gas assets (those used in the exploration, evaluation, development or production of oil and gas) on the date of transition to this [draft] FRS at

the amount determined under the entity's previous GAAP. The entity shall test those assets for impairment at the date of transition to this [draft] FRS in accordance with Section 27 *Impairment of Assets*.

- (k) ***Arrangements containing a lease.*** A first-time adopter may elect to determine whether an arrangement existing at the date of transition to this [draft] FRS contains a lease (see paragraph 20.3) on the basis of facts and circumstances existing at that date, rather than when the arrangement was entered into.
 - (l) ***Decommissioning liabilities included in the cost of property, plant and equipment.*** Paragraph 17.10(c) states that the cost of an item of property, plant and equipment includes the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for 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. A first-time adopter may elect to measure this component of the cost of an item of property, plant and equipment at the date of transition to this [draft] FRS, rather than on the date(s) when the obligation initially arose.
 - (m) ***Dormant companies**** a company within the Companies Act definition of a dormant company may elect to retain its accounting policies for measurement of reported assets, liabilities and equity at the date of transition to this [draft] FRS until there is any change to those balances or the company undertakes any new transactions.
 - (n) ***Deferred development costs as a deemed cost.*** A first-time adopter may elect to measure the carrying amount at the date of transition to this [draft] FRS for development costs deferred in accordance with SSAP 13 'Research and development' as its deemed cost at that date.
 - (o) ***Borrowing costs.*** An entity electing to adopt an accounting policy of capitalising borrowing costs as part of the cost of a qualifying asset may elect to treat the date of transition to this [draft] FRS as the date on which capitalisation commences.
 - (p) ***Public benefit entity combinations.*** A first time adopter may elect not to apply those paragraphs in section 34 relating to public benefit entity combinations that were effected before the date of transition to this [draft] FRS. However, if on first-time adoption a public benefit entity restates any entity combination to comply with this section, it shall restate all later entity combinations.
- 35.11 If it is **impracticable** for an entity to restate the opening statement of financial position at the date of transition for one or more of the adjustments required by paragraph 35.7, the entity shall apply paragraphs 35.7–35.10 for such adjustments in the earliest period for which it is practicable to do so, and shall identify the data presented for prior periods that are not comparable with data for the period in which it prepares its first financial statements that conform to this [draft] FRS. If it is impracticable for an entity to provide any disclosures required by this [draft] FRS for any period before the period in which it prepares its first financial statements that conform to this [draft] FRS, the omission shall be disclosed.

* Irish company law does not contain an equivalent definition.

Disclosures

Explanation of transition to this [draft] FRS

- 35.12 An entity shall explain how the transition from its previous financial reporting framework to this [draft] FRS affected its reported **financial position**, financial **performance** and **cash flows**.

Reconciliations

- 35.13 To comply with paragraph 35.12, an entity's first financial statements prepared using this [draft] FRS shall include:
- (a) a description of the nature of each change in accounting policy.
 - (b) reconciliations of its equity determined in accordance with its previous financial reporting framework to its equity determined in accordance with this [draft] FRS for both of the following dates:
 - (i) the date of transition to this [draft] FRS, and
 - (ii) the end of the latest period presented in the entity's most recent annual financial statements determined in accordance with its previous financial reporting framework.
 - (c) a reconciliation of the profit or loss determined in accordance with its previous financial reporting framework for the latest period in the entity's most recent annual financial statements to its profit or loss determined in accordance with this [draft] FRS for the same period.
- 35.14 If an entity becomes aware of errors made under its previous financial reporting framework, the reconciliations required by paragraph 35.13(b) and (c) shall, to the extent practicable, distinguish the correction of those errors from changes in accounting policies.
- 35.15 If an entity did not present financial statements for previous periods, it shall disclose that fact in its first financial statements that conform to this [draft] FRS.

GLOSSARY OF TERMS

accounting policies	The specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
accrual basis of accounting	The effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.
accumulating compensated absences	Compensated absences that are carried forward and can be used in future periods if the current period's entitlement is not used in full.
acquisition date	The date on which the acquirer obtains control of the acquiree.
Act	The Companies Act 2006
active market	A market in which all the following conditions exist: (a) the items traded in the market are homogeneous; (b) willing buyers and sellers can normally be found at any time; and (c) prices are available to the public.
actuarial assumptions	An entity's unbiased and mutually compatible best estimates of the demographic and financial variables that will determine the ultimate cost of providing post-employment benefits.
actuarial gains and losses	Changes in the present value of the defined benefit pension 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.
agricultural activity	The management by an entity of the biological transformation of biological assets for sale, into agricultural produce or into additional biological assets.
agricultural produce	The harvested product of the entity's biological assets.
amortisation	The systematic allocation of the depreciable amount of an asset over its useful life.
amortised cost of a financial asset or financial liability	The amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.
asset	A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
asset held by a long-term employee benefit fund	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.

associate	An entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.
biological asset	A living animal or plant.
borrowing costs	Interest and other costs incurred by an entity in connection with the borrowing of funds.
business	<p>An integrated set of activities and assets conducted and managed for the purpose of providing:</p> <ul style="list-style-type: none"> (a) a return to investors, or (b) lower costs or other economic benefits directly and proportionately to policyholders or participants. <p>A business generally consists of inputs, processes applied to those inputs, and resulting outputs that are, or will be, used to generate revenues. If goodwill is present in a transferred set of activities and assets, the transferred set shall be presumed to be a business.</p>
business combination	The bringing together of separate entities or businesses into one reporting entity.
carrying amount	The amount at which an asset or liability is recognised in the statement of financial position.
cash	Cash on hand and demand deposits.
cash equivalent	Short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value.
cash flows	Inflows and outflows of cash and cash equivalents.
cash-generating unit	The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.
cash-settled share-based payment transaction	A share-based payment transaction in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity.
change in accounting estimate	An adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.
class of assets	A grouping of assets of a similar nature and use in an entity's operations.

close members of the family of a person	Are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and include: (a) that person's children and spouse or domestic partner; (b) children of that person's spouse or domestic partner; and (c) dependants of that person or that person's spouse or domestic partner.
closing rate	The spot exchange rate at the end of the reporting period
combination of entities or business combination under common control	Common control means that all of the combining entities or businesses are ultimately controlled by the same party (or parties) both before and after the business combination, and that control is not transitory. Any of the following arrangements: (a) the transfer of an equity holding in a subsidiary from one group entity to another; (b) the addition of a new parent entity to a group; (c) the transfer of equities in one or more subsidiaries of a group to a new entity that is not a group entity but whose equity holders are the same as those of the group's parent; or (d) the combination into a group of two or more entities that before the combination had the same equity holders.
combined financial statements	The financial statements of two or more entities controlled by a single investor.
commencement of lease term	The date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease (ie the recognition of the assets, liabilities, income or expenses resulting from the lease, as appropriate).
component of an entity	Operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.
compound financial instrument	A financial instrument that, from the issuer's perspective, contains both a liability and an equity element.
concessionary loan	A loan made by a public benefit entity to a third party at below the prevailing market rate of interest which is not repayable on demand.
consolidated financial statements	The financial statements of a parent and its subsidiaries presented as those of a single economic entity.
construction contract	A contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.
constructive obligation	An obligation that derives from an entity's actions where: (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and (b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.
contingent asset	A possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

contingent liability	<ul style="list-style-type: none"> (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 recognised because: <ul style="list-style-type: none"> (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) the amount of the obligation cannot be measured with sufficient reliability.
contingent rent	That portion of the lease payments that is not fixed in amount but is based on the future amount of a factor that changes other than with the passage of time (eg percentage of future sales, amount of future use, future price indices, future market rates of interest).
control (of an entity)	The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.
credit risk	The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.
current assets	Assets of an entity which are not intended for use on a continuing basis in the entity's activities.
current replacement cost	The cost the entity would incur to acquire the asset at the end of the reporting period.
current tax	The amount of income tax payable (refundable) in respect of the taxable profit (tax loss) for the current period or past reporting periods.
date of transition to this [draft] FRS	The beginning of the earliest period for which an entity presents full comparative information under this [draft] FRS in its first financial statements that comply with this [draft] FRS.
deemed cost	An amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation or amortisation assumes that the entity had initially recognised the asset or liability at the given date and that its cost was equal to the deemed cost.
deferred tax	Income tax payable (recoverable) in respect of the taxable profit (tax loss) for future reporting periods as a result of past transactions or events.
deferred tax assets	Income tax recoverable in future reporting periods in respect of: <ul style="list-style-type: none"> (a) future tax consequences of transactions and events recognised in the financial statements of the current and previous periods; (b) the carry forward of unused tax losses; and (c) the carry forward of unused tax credits.
deferred tax liabilities	Income tax payable in future reporting periods in respect of future tax consequences of transactions and events recognised in the financial statements of the current and previous periods.
defined benefit liability	The present value of the defined benefit obligation at the reporting date minus the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly.

defined benefit obligation (present value of)	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.
defined benefit plans	Post-employment benefit plans other than defined contribution plans.
defined contribution plans	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 or to make direct benefit payments to employees if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.
depreciable amount	The cost of an asset, or other amount substituted for cost (in the financial statements), less its residual value.
depreciated replacement cost	The most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date.
depreciation	The systematic allocation of the depreciable amount of an asset over its useful life.
derecognition	The removal of a previously recognised asset or liability from an entity's statement of financial position.
derivative	<p>A financial instrument or other contract with all three of the following characteristics:</p> <ul style="list-style-type: none"> (a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying'); (b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and (c) it is settled at a future date.
development	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.
discontinued operation	<p>A component of an entity that has been disposed of and:</p> <ul style="list-style-type: none"> (a) represents a separate major line of business or geographical area of operations, (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations, or (c) is a subsidiary acquired exclusively with a view to resale.
discretionary participation feature	<p>A contractual right to receive, as a supplement to guaranteed benefits, additional benefits:</p> <ul style="list-style-type: none"> (a) that are likely to be a significant portion of the total contractual benefits; (b) whose amount or timing is contractually at the discretion of the issuer; and (c) that are contractually based on: <ul style="list-style-type: none"> (i) the performance of a specified pool of contracts or a specified type of contract; (ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or

- (iii) the profit or loss of the company, fund or other entity that issues the contract.

disposal group	A group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. The group includes goodwill acquired in a business combination if the group is a cash-generating unit to which goodwill has been allocated in accordance with the requirements of Section 27 paragraphs 24 to 27 of this [draft] FRS.
effective interest method	A method of calculating the amortised cost of a financial asset or a financial liability (or a group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.
effective interest rate	The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.
effectiveness of a hedge	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.
employee benefits	All forms of consideration given by an entity in exchange for service rendered by employees.
entity combination	See business combination.
equity	The residual interest in the assets of the entity after deducting all its liabilities.
equity-settled share-based payment transaction	A share-based payment transaction in which the entity receives goods or services as consideration for equity instruments of the entity (including shares or share options).
errors	<p>Omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:</p> <ul style="list-style-type: none"> (a) was available when financial statements for those periods were authorised for issue, and (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.
expenses	Decreases in economic benefits during the reporting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity investors.
EU-adopted IFRS	International Financial Reporting Standards (IFRSs) as adopted for use in the European Union.
fair presentation	Faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses.

fair value	The amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction.
fair value less costs to sell	The amount obtainable from the sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.
finance lease	A lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred. A lease that is not a finance lease is an operating lease.
financial asset	Any asset that is: <ul style="list-style-type: none"> (a) cash; (b) an equity instrument of another entity; (c) a contractual right: <ul style="list-style-type: none"> (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 favourable to the entity; or (d) a contract that will or may be settled in the entity's own equity instruments and: <ul style="list-style-type: none"> (i) under which the entity is or may be obliged to receive a variable number of the entity's own equity instruments, or (ii) 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 instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.
financial institution	Either: <ul style="list-style-type: none"> (a) a bank which is: <ul style="list-style-type: none"> (i) a firm with a Part IV permission* which includes accepting deposits; and: <ul style="list-style-type: none"> a. which is a credit institution; or b. whose Part IV permission includes a requirement that it complies with the rules in the General Prudential sourcebook and the Prudential sourcebook for Banks, Building Societies and Investment Firms relating to banks, but which is not a building society, a friendly society or a credit union; or (ii) an EEA bank which is a full credit institution; or (b) a building society which is defined in section 119(1) of the Building Societies Act 1986 as a building society incorporated (or deemed to be incorporated) under that Act; or (c) an entity that undertakes the business of effecting or carrying out insurance contracts, including general and life assurance entities; or (d) an investment trust, Irish Investment Company[†], venture capital trust, mutual fund, exchange traded fund, unit trust, open-ended investment company (OEIC), custodian bank or stockbroker; or (e) a credit union, being a body corporate registered under the Industrial and Provident Societies Act 1965 as a credit union in accordance with the Credit Unions Act 1979, which is an authorised person; or (f) an incorporated friendly society or a registered friendly society; or

* As defined in section 40(4) of the Financial Services and Markets Act 2000.

† An Investment Company is a corporate vehicle formed under section 47(3) of the Companies (Amendment) Act 1983 and section 58 of the Companies (Amendment) Act 1986, and regulated by the Irish Financial Regulator.

(g) a retirement benefit plan.

financial instrument A contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

financial liability 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 unfavourable to the entity, or
- (b) a contract that will or may be settled in the entity's own equity instruments and:
 - (i) under which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments, or
 - (ii) 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 instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

financial position The relationship of the assets, liabilities and equity of an entity as reported in the statement of financial position.

financial statements Structured representation of the financial position, financial performance and cash flows of an entity.

financial risk The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

financing activities Activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

firm commitment A binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.

first-time adopter of this [draft] FRS An entity that presents its first annual financial statements that conform to this [draft] FRS, regardless of whether its previous accounting framework was EU-adopted IFRS or another set of accounting standards.

fixed assets Assets of an entity which are intended for use on a continuing basis in the entity's activities.

forecast transaction An uncommitted but anticipated future transaction.

FRSSE The FRS 'Financial Reporting Standard for Smaller Entities'.

functional currency The currency of the primary economic environment in which the entity operates.

funding (of post-employment benefits) 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.

gains	Increases in economic benefits that meet the definition of income but are not revenue.
general purpose financial statements	Financial statements directed to the general financial information needs of a wide range of users who are not in a position to demand reports tailored to meet their particular information needs.
going concern	An entity is a going concern unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.
goodwill	Future economic benefits arising from assets that are not capable of being individually identified and separately recognised.
government grants	Assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity.
grant date	The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.
gross investment in a lease	The aggregate of: (a) the minimum lease payments receivable by the lessor under a finance lease, and (b) any unguaranteed residual value accruing to the lessor.
group	A parent and all its subsidiaries.
hedged item	For the purpose of special hedge accounting under Section 12 of this [draft] FRS, a hedged item is: (a) interest rate risk of a debt instrument measured at amortised cost; (b) foreign exchange or interest rate risk in a firm commitment or a highly probable forecast transaction; (c) price risk of a commodity that it holds or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity; or (d) foreign exchange risk in a net investment in a foreign operation.
hedging instrument	For the purpose of special hedge accounting by entities within the scope of this [draft] FRS under Section 12 of this [draft] FRS, a hedging instrument is a financial instrument that meets all of the following terms and conditions: (a) it is an interest rate swap, a foreign currency swap, a cross currency interest rate swap, a foreign currency forward exchange contract, a commodity forward exchange contract, or for a hedge of a foreign exchange risk in a net investment in a foreign operation; a financial asset; or financial liability that is expected to be highly effective in offsetting a risk identified in paragraph 12.17 that is designated as the hedged risk. (b) it involves a party external to the reporting entity (ie external to the group, segment or individual entity being reported on). (c) its notional amount is equal to the designated amount of the principal or notional amount of the hedged item. (d) it has a specified maturity date not later than (i) the maturity of the financial instrument being hedged,

- (ii) the expected settlement of the commodity purchase or sale commitment, or
- (iii) the later of the occurrence and settlement of the highly probable forecast foreign currency or commodity transaction being hedged.
- (e) it has no prepayment, early termination or extension features other than at fair value.

An entity that chooses to apply IAS 39 *Financial Instruments: Recognition and Measurement* (as adopted in the EU) in accounting for financial instruments shall apply the definition of hedging instrument in that standard rather than this definition.

held exclusively with a view to subsequent resale	<p>An interest:</p> <ul style="list-style-type: none"> (a) for which a purchaser has been identified or is being sought, and which is reasonably expected to be disposed of within approximately one year of its date of acquisition; or (b) that was acquired as a result of the enforcement of a security, unless the interest has become part of the continuing activities of the group or the holder acts as if it intends the interest to become so; or (c) which is held as part of an investment portfolio.
heritage asset	An item of property, plant and equipment with historic, artistic, scientific, technological, geophysical, or environmental qualities that is held and maintained principally for its contribution to knowledge and culture.
highly probable	Significantly more likely than probable.
IAS Regulation	Refers to EU Regulation 1606/2002.
impairment loss	The amount by which the carrying amount of an asset exceeds (a) in the case of inventories, its selling price less costs to complete and sell or (b) in the case of other assets, its recoverable amount.
impracticable	Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.
imputed rate of interest	<p>The more clearly determinable of either:</p> <ul style="list-style-type: none"> (a) the prevailing rate for a similar instrument of an issuer with a similar credit rating, or (b) a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.
income	Increases in economic benefits during the reporting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity investors.
income and expenditure	The total of income less expenses, excluding the components of other comprehensive income. In the for-profit sector this is known as profit or loss .
income statement	Financial statement that presents all items of income and expense recognised in a reporting period, excluding the items of other comprehensive income.
income tax	All domestic and foreign taxes that are based on taxable profits. Income tax also includes taxes, such as withholding taxes, that are payable by a subsidiary, associate or joint venture on distributions to the reporting entity.

insurance contract	A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.
intangible asset	An identifiable non-monetary asset without physical substance. Such an asset is identifiable when it: <ul style="list-style-type: none"> (a) is separable, ie 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, asset or liability, or (b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
interest rate implicit in the lease	The discount rate that, at the inception of the lease, causes the aggregate present value of (a) the minimum lease payments and (b) the unguaranteed residual value to be equal to the sum of (i) the fair value of the leased asset and (ii) any initial direct costs of the lessor.
interim financial report	A financial report containing either a complete set of financial statements or a set of condensed financial statements for an interim period.
interim period	A financial reporting period shorter than a full financial year.
International Financial Reporting Standards (IFRSs)	Standards and Interpretations issued (or adopted) by the International Accounting Standards Board (IASB). They comprise: <ul style="list-style-type: none"> (a) International Financial Reporting Standards; (b) International Accounting Standards; and (c) Interpretations developed by the IFRS Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).
intrinsic value	The difference between the fair value of the shares to which the counterparty has the (conditional or unconditional) right to subscribe or which it has the right to receive, and the price (if any) the counterparty is (or will be) required to pay for those shares. For example, a share option with an exercise price of CU15, on a share with a fair value of CU20, has an intrinsic value of CU5.
inventories	Assets: <ul style="list-style-type: none"> (a) held for sale in the ordinary course of business; (b) in the process of production for such sale; or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.
inventories held for distribution	Assets that are; <ul style="list-style-type: none"> (a) held for distribution at no or nominal consideration in the ordinary course of operations; (b) in the process of production for distribution at no or nominal consideration in the ordinary course of operations; or (c) in the form of material or supplies to be consumed in the production process or in the rendering of services at no or nominal consideration.
investing activities	The acquisition and disposal of long-term assets and other investments not included in cash equivalents.

investment property	Property (land or a building, or part of a building, or both) held by the owner or by the lessee under a finance lease to earn rentals or for capital appreciation or both, rather than for: (a) use in the production or supply of goods or services or for administrative purposes, or (b) sale in the ordinary course of business.
joint control	The contractually agreed sharing of control over an economic activity. It exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).
joint venture	A contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures can take the form of jointly controlled operations, jointly controlled assets, or jointly controlled entities.
jointly controlled entity	A joint venture that involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other entities, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity.
lease	An agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.
lease term	The non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.
lessee's incremental borrowing rate of interest	The rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.
liability	A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
liquidity risk	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	Financial liabilities other than short-term trade payables on normal credit terms.
market risk	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. Interest rate risk – the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Currency risk – the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Other price risk – 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 financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

market condition	A condition upon which the exercise price, vesting or exercisability of an equity instrument depends that is related to the market price of the entity's equity instruments, such as attaining a specified share price or a specified amount of intrinsic value of a share option, or achieving a specified target that is based on the market price of the entity's equity instruments relative to an index of market prices of equity instruments of other entities.
material	Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.
measurement	The process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the statement of financial position and statement of comprehensive income.
merger	<p>An entity combination that results in the creation of a new reporting entity formed from the combining parties, in which the controlling parties of the combining entities come together in a partnership for the mutual sharing of risks and benefits of the newly formed entity and in which no party to the combination in substance obtains control over any other, or is otherwise seen to be dominant.</p> <p>All of the following criteria must be met for an entity combination to meet the definition of a merger:</p> <ul style="list-style-type: none"> (a) no party to the combination is portrayed as either acquirer or acquiree, either by its own board or management or by that of another party to the combination; (b) there is no significant change to the classes of beneficiaries of the combining entities or the purpose of the benefits provided as a result of the combination; and (c) all parties to the combination, as represented by the members of the board, participate in establishing the management structure of the combined entity and in selecting the management personnel, and such decisions are made on the basis of a consensus between the parties to the combination rather than purely by exercise of voting rights.
minimum lease payments	<p>The payments over the lease term that the lessee is or can be required to make, excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with:</p> <ul style="list-style-type: none"> (a) for a lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or (b) for a lessor, any residual value guaranteed to the lessor by: <ul style="list-style-type: none"> (i) the lessee; (ii) a party related to the lessee; or (iii) a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.
monetary items	Units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.
multi-employer (benefit) plans	<p>Defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:</p> <ul style="list-style-type: none"> (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 concerned.

net investment in a foreign operation	The amount of the reporting entity's interest in the net assets of that operation.
net investment in a lease	The gross investment in a lease discounted at the interest rate implicit in the lease.
non-controlling interest	The equity in a subsidiary not attributable, directly or indirectly, to a parent.
non-exchange transaction	A transaction whereby an entity receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.
notes (to financial statements)	Notes contain information in addition to that presented in the statement of financial position, statement of comprehensive income, income statement (if presented), combined statement of income and retained earnings (if presented), statement of changes in equity and statement of cash flows. Notes provide narrative descriptions or disaggregations of items presented in those statements and information about items that do not qualify for recognition in those statements.
notional amount	The quantity of currency units, shares, bushels, pounds or other units specified in a financial instrument contract.
objective of financial statements	To provide information about the financial position, performance and cash flows of an entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs.
onerous contract	A contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.
operating activities	The principal revenue-producing activities of the entity and other activities that are not investing or financing activities.
operating lease	A lease that does not transfer substantially all the risks and rewards incidental to ownership. A lease that is not an operating lease is a finance lease.
operating segment	An operating segment is a component of an entity: <ul style="list-style-type: none"> (a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity); (b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance; and (c) for which discrete financial information is available.
ordinary share	An equity instrument that is subordinate to all other classes of equity instrument.
other comprehensive income	Items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by this [draft] FRS.
owners	Holders of instruments classified as equity.
parent	An entity that has one or more subsidiaries.

performance	The relationship of the income and expenses of an entity, as reported in the statement of comprehensive income.
performance conditions	A requirement that specifies that the resource is either to be used by the recipient as specified, or if not so used, to be returned to the donor.
plan assets (of an employee benefit plan)	(a) assets held by a long-term employee benefit fund; and (b) qualifying insurance policies.
post-employment benefits	Employee benefits (other than termination benefits and short-term employee benefits) that are payable after the completion of employment.
post-employment benefit plans	Formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.
potential ordinary share	A financial instrument or other contract that may entitle its holder to ordinary shares.
present value	A current estimate of the present discounted value of the future net cash flows in the normal course of business.
presentation currency	The currency in which the financial statements are presented.
prevailing market rate	The rate of interest that would apply to the entity in an open market for a similar financial instrument.
probable	More likely than not.
profit or loss	The total of income less expenses, excluding the components of other comprehensive income.
projected unit credit method	An actuarial valuation method that sees each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation (sometimes known as the accrued benefit method pro-rated on service or as the benefit/years of service method).
property, plant and equipment	Tangible assets that: (a) are held for use in the production or supply of goods or services, for rental to others, for investment, or for administrative purposes, and (b) are expected to be used during more than one period.
prospective application (of a change in accounting policy)	Applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed.
provision	A liability of uncertain timing or amount.
prudence	The inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated.

public benefit entity	An entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any equity is provided with a view to supporting the entity's primary objectives rather than with a view to providing a financial return to equity providers, shareholders or members.
publicly traded (debt or equity instruments)	Traded, or in process of being issued for trading, in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).
qualifying asset	An asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Depending on the circumstances any of the following may be qualifying assets inventories, manufacturing plants, power generation facilities, intangible assets and investment properties. Financial assets, and inventories that are produced over a short period of time, are not qualifying assets.
qualifying entity	A member of a group that prepares publicly available financial statements, which give a true and fair view, in which that member is consolidated.
recognition	<p>The process of incorporating in the statement of financial position or statement of comprehensive income an item that meets the definition of an element and that satisfies the following criteria:</p> <ul style="list-style-type: none"> (a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and (b) the item has a cost or value that can be measured with reliability.
recoverable amount	The higher of an asset's (or cash-generating unit's) fair value less costs to sell and its value in use.
Regulations	The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.
reinsurance contract	An insurance contract issued by one insurer (the reinsurer) to compensate another insurer (the cedant) for losses on one or more contracts issued by the cedant.
related party	<p>A related party is a person or entity that is related to the entity that is preparing its financial statements (the reporting entity).</p> <ul style="list-style-type: none"> (a) A person or a close member of that person's family is related to a reporting entity if that person: <ul style="list-style-type: none"> (i) has control or joint control over the reporting entity; (ii) has significant influence over the reporting entity; or (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity. (b) An entity is related to a reporting entity if any of the following conditions applies: <ul style="list-style-type: none"> (i) the entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others). (ii) one entity is an associate or joint venture of the other entity (or of a member of a group of which the other entity is a member). (iii) both entities are joint ventures of the same third entity. (iv) one entity is a joint venture of a third entity and the other entity is an associate of the third entity. (v) the entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the

- reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
- (vi) the entity is controlled or jointly controlled by a person identified in (a).
 - (vii) a person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

related party transaction	A transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.
relevance	The quality of information that allows it to influence the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.
reliability	The quality of information that makes it free from material error and bias and represent faithfully that which it either purports to represent or could reasonably be expected to represent.
reporting date	The end of the latest period covered by financial statements or by an interim financial report.
reporting period	The period covered by financial statements or by an interim financial report.
research	Original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.
residual value (of an asset)	The estimated amount that an entity would currently obtain from disposal of an asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.
restrictions	A requirement that limits or directs the purposes for which a resource may be used but does not require that resource to be returned to the donor if the resource is not used as specified.
retirement benefit plan	Arrangements whereby an entity provides benefits for employees on or after termination of service (either in the form of an annual income or as a lump sum) when such benefits, or the contributions towards them, can be determined or estimated in advance of retirement from the provisions of a document or from the entity's practice.
retrospective application (of a change in accounting policy)	Applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.
revenue	The gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.
separate financial statements	Those presented by a parent in which the investments in subsidiaries, associates or jointly controlled entities are accounted for either at cost or fair value rather than on the basis of the reported results and net assets of the investees.

service concession arrangement	An arrangement whereby a government or other public sector body contracts with a private operator to develop (or upgrade), operate and maintain the grantor's infrastructure assets such as roads, bridges, tunnels, airports, energy distribution networks, prisons or hospitals.
service potential	The economic utility of an asset, based on the total benefit expected to be derived by the entity from use (and/or through sale) of the asset.
share-based payment transaction	A transaction in which the entity receives goods or services (including employee services) as consideration for equity instruments of the entity (including shares or share options), or acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price of the entity's shares or other equity instruments of the entity.
share option	A contract that gives the holder the right, but not the obligation, to subscribe to the entity's shares at a fixed or determinable price for a specific period of time.
SORP	An extant Statement of Recommended Practice (SORP) developed in accordance with SORPs: Policy and Code of Practice, and including a statement by the Board. SORPs recommend accounting practices for specialised industries or sectors. They supplement accounting standards and other legal and regulatory requirements in the light of the special factors prevailing or transactions undertaken in a particular industry or sector.
state	A national, regional, or local government.
state (employee benefit) plan	Employee benefit plans established by legislation to cover all entities (or all entities in a particular category, for example a specific industry) and operated by national or local government or by another body (for example an autonomous agency created specifically for this purpose) which is not subject to control or influence by the reporting entity.
statement of cash flows	Financial statement that provides information about the changes in cash and cash equivalents of an entity for a period, showing separately changes during the period from operating, investing and financing activities.
statement of comprehensive income	Financial statement that presents all items of income and expense recognised in a period, including those items recognised in determining profit or loss (which is a subtotal in the statement of comprehensive income) and items of other comprehensive income. If an entity chooses to present both an income statement and a statement of comprehensive income, the statement of comprehensive income begins with profit or loss and then displays the items of other comprehensive income.
statement of financial position	Financial statement that presents the relationship of an entity's assets, liabilities and equity as of a specific date (also called the balance sheet).
statement of income and retained earnings	Financial statement that presents the profit or loss and changes in retained earnings for a period.
subsidiary	An entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).
substantively enacted	Tax rates shall be regarded as substantively enacted when future events required by the enactment process will not change the outcome.

tax expense	The aggregate amount included in total comprehensive income or equity for the reporting period in respect of current tax and deferred tax.
taxable profit (tax loss)	The profit (loss) for a reporting period upon which income taxes are payable or recoverable, determined in accordance with the rules established by the taxation authorities. Taxable profit equals taxable income less amounts deductible from taxable income.
termination benefits	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 voluntary redundancy in exchange for those benefits.
timing differences	Income or expenses that are recognised in profit or loss in one period but, under tax laws or regulations, are included in taxable income in a different period.
timeliness	Providing the information in financial statements within the decision time frame.
total comprehensive income	The change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners (equal to the sum of profit or loss and other comprehensive income).
transaction costs (financial instruments)	Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see IAS 39 paragraph AG13). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.
treasury shares	An entity's own equity instruments, held by the entity or other members of the consolidated group.
understandability	The presentation of information in a way that makes it comprehensible by users who have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.
useful life	The period over which an asset is expected to be available for use by an entity or the number of production or similar units expected to be obtained from the asset by an entity.
value in use	The present value of the future cash flows expected to be derived from an asset or cash-generating unit.
value in use (in respect of assets held for their service potential)	When the future economic benefits of an asset are not primarily dependent on the asset's ability to generate net cash inflows, value in use is the present value to the entity of the asset's remaining service potential if it continues to be used, plus the net amount that the entity will receive from its disposal at the end of its useful life.
venturer	A party to a joint venture that has joint control over that joint venture.
vest	Become an entitlement. Under a share-based payment arrangement, a counterparty's right to receive cash, other assets or equity instruments of the

entity vests when the counterparty's entitlement is no longer conditional on the satisfaction of any vesting conditions.

vested benefits Benefits, the rights to which, under the conditions of a retirement benefit plan, are not conditional on continued employment.

The term **individual accounts**, from the Act, is also used; separate financial statements (defined in IFRS) are included within the meaning of this term.

APPENDIX 1: SIGNIFICANT DIFFERENCES BETWEEN THE [DRAFT] FRS APPLICABLE IN THE UK & REPUBLIC OF IRELAND AND THE IFRS FOR SMES

Section		[Draft] Changes to the IFRS for SMEs
1	Scope of this [draft] FRS	This section of the IFRS for SMEs has been replaced. The IFRS for SMEs applies to small and medium sized entities that do not have public accountability and publish general purpose financial statements. The [draft] FRS [100] 'Application of Financial Reporting Requirements' sets out the scope of entities applying this [draft] FRS.
2	Concepts and Pervasive Principles	Paragraphs 2.53 to 2.56 are inserted to provide guidance on 'intermediate payment arrangements'; these were previously contained in UITF Abstract 32.
3	Financial Statement Presentation	The requirements in paragraph 3.7 are deleted and requirements set out in the Act are inserted for the use of the true and fair override. Paragraph 3.16 is amended to clarify the role of materiality in the preparation of financial statements. Paragraph 3.16A is inserted to specify that disclosures are not required if the information is not material.
4	Statement of Financial Position	The requirements of this section have predominantly been removed and replaced by the requirements set out in the Act. Entities that do not report under the Act comply with the requirements of this section, and of the Regulations, except to the extent that these requirements are not permitted by any statutory framework under which such entities report.
5	Statement of Comprehensive Income and Income Statement	The requirements of this section have predominantly been removed and replaced by the requirements set out in the Act. Entities that do not report under the Act comply with the requirements of this section and of the Regulations except to the extent that these requirements are not permitted by any statutory framework under which such entities report. Paragraph 5.10 has been amended and paragraph 5.10A is inserted to comply with the Act and includes the definition of an extraordinary item.
6	Statement of Changes in Equity and Statement of Income and Retained Earnings	Paragraph 6.3A is inserted to require presentation for each component of equity an analysis of other comprehensive income by item, either in the notes, or in the statement of changes in equity.
7	Statement of Cash Flows	The scope of this section is amended to exclude mutual life assurance companies, pension funds and certain open ended investment funds. Paragraph 7.11 provides some relaxation of the exchange rates permitted to be used.
8	Notes to the Financial Statements	No significant changes.
9	Consolidated and Separate Financial Statements	The scope of this section is amended to clarify that it applies to all parent entities that present consolidated financial statements intended to give a true and fair view.

Section		[Draft] Changes to the IFRS for SMEs
		<p>The requirements to present consolidated financial statements are amended to comply with the Act.</p> <p>Paragraph 9.9 permits subsidiaries held exclusively with a view to subsequent resale which have not previously been consolidated in the consolidated financial statements and are held as part of an investment portfolio by to be excluded from consolidation. Such subsidiaries are required to be measured at fair value with changes recognised in profit or loss. In addition paragraph 14.4B and 15.9B are inserted to clarify that investment entities with associate entity investments, or jointly controlled entities respectively that are held as part of an investment portfolio, are measured at fair value with the changes recognised in profit or loss.</p> <p>Clarification is added to paragraph 9.10 that Employee Share Ownership Plans and similar arrangements are Special Purpose Entities.</p> <p>Paragraph 9.16 is amended to comply with company law.</p> <p>Paragraph 9.18A is inserted to clarify how the gain or loss on disposals of a subsidiary is calculated.</p> <p>Paragraph 9.24 clarifies that the Act specifies when separate financial statements are required to be prepared.</p> <p>Paragraphs 9.31 and 9.32 provide guidance on exchanges of businesses or other non-monetary assets for an interest in a subsidiary, joint venture or associate. This guidance has previously contained in UITF Abstract 31.</p>
10	Accounting Policies, Estimates and Errors	Paragraph 10.5 clarifies when an entity is required to refer to SORPs in developing an accounting policy.
11	Basic Financial Instruments	<p>The scope of section 11 is amended to clarify that certain financial instruments are not within its scope.</p> <p>Paragraph 11.9(c) is amended to clarify that contractual prepayment provisions are not contingent future events unless they protect the holder from credit deterioration or tax changes.</p> <p>Paragraph 11.48A is inserted to provide relevant disclosures required in accordance with the Regulations for financial instruments that are not held as part of a trading portfolio and are not derivatives.</p>
12	Other Financial Instruments Issues	Paragraph 12.23 clarifies that the cumulative amount of foreign exchange differences relating to a hedge of a net investment in a foreign operation are reclassified to profit or loss on disposal or partial disposal.
13	Inventories	No significant changes.
14	Investments in Associates	<p>The scope of this section is amended to clarify its application to consolidated financial statements and to the financial statements of an entity that is not a parent but which holds investments in associates.</p> <p>Paragraph 14.4(c) of the IFRS for SMEs is deleted as it is not compliant with company law.</p>

Section		[Draft] Changes to the IFRS for SMEs
15	Investments in Joint Ventures	The scope of this section is amended to clarify its application to consolidated financial statements and to the financial statements of a venturer.
16	Investment Property	No significant changes.
17	Property, Plant and Equipment	The section is amended to provide, after initial recognition, that an entity may use the cost model or revaluation model.
18	Intangible Assets other than Goodwill	<p>This section is amended to permit entities to recognise intangible assets that result from expenditure incurred on the internal development of an intangible item (subject to certain criteria). The section provides guidance on what comprises the cost of an internally generated intangible asset and the criteria for initial recognition.</p> <p>The section is also amended to provide, after initial recognition, that an entity may use the cost model or revaluation model.</p>
19	Business Combinations and Goodwill	<p>This section is amended to permit combinations of entities or businesses under common control to use the merger method of accounting. The merger method is set out in paragraphs 19.27 to 19.33.</p> <p>Paragraph 19.23(a) is amended to comply with company law such that, where an entity is unable to make a reliable estimate of the useful life of goodwill, the life shall be presumed to be 5 years rather than 10 years as set out in the IFRS for SMEs.</p>
20	Leases	No significant changes.
21	Provisions and Contingencies	No significant changes.
22	Liabilities and Equity	<p>Clarification is provided in paragraph 22.3A that a financial instrument where the issuer does not have the unconditional right to avoid settling in cash or by delivery of another financial asset (or otherwise to settle it in such a way that it would be a financial liability); and where settlement is dependent on the occurrence or non-occurrence of uncertain future events beyond the control of the issuer and the holder, is a financial liability of the issuer unless specific circumstances apply.</p> <p>The requirement for an entity to recognise a liability at fair value when non-cash assets are distributed to owners is removed and only disclosure is required.</p>
23	Revenue	No significant changes.
24	Grants	<p>The scope of this section is amended to clarify that it applies to all grants and not only those from governments.</p> <p>An additional model of accounting for grants is introduced. The model permits entities to recognise grant income on a systematic basis over the period in which the entity recognises the related costs for which the grant is intended to compensate.</p>
25	Borrowing Costs	An option is introduced that permits entities to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.
26	Share-based Payment	No significant changes, however, the ASB has clarified that option pricing models do not have to be applied in all circumstances.

Section		[Draft] Changes to the IFRS for SMEs
27	Impairment of Assets	No significant changes.
28	Employee Benefits	The presentation of the cost of a defined benefit plan and the accounting for group plans have been amended to be consistent with the requirements of IAS 19 <i>Employee Benefits</i> as amended in 2011.
29	Income Tax	This section of the IFRS for SMEs has been entirely replaced with revised requirements.
30	Foreign Currency Translation	No significant changes.
31	Hyperinflation	No significant changes.
32	Events after the End of the Reporting Period	No significant changes.
33	Related Party Disclosures	The exemption from disclosure of related party transactions for wholly-owned entities available in company law has been inserted.
34	Specialised Activities	New sections have been inserted for: (a) heritage assets; (b) financial institutions; and (c) public benefit entities.
35	Transition to this [draft] FRS	Amendments to this section reflect the changes in preceding sections.

APPENDIX II: TABLE OF EQUIVALENCE FOR UK AND IRISH COMPANIES ACT TERMINOLOGY

The following table compares company law terminology with equivalent terminology used in this [draft] FRS. In some cases there are minor differences between broadly equivalent definitions, which are also summarised below.

Company law terminology	[Draft] FRS terminology	EU-adopted IFRS terminology (where different from [draft] FRS)
Accounts	Financial statements	
Associated undertaking	Associate	
Balance sheet	Statement of financial position	
Capital and reserves	Equity	
Cash at bank and cash in hand	Cash [*]	
Creditors: amounts falling due after more than one year		Non-current liabilities (although this includes deferred tax liabilities and, for example, provisions expected to be settled after more than one year)
Creditors: amounts falling due within one year		Current liabilities (although this includes, for example, provisions expected to be settled within one year)
Debtors	Trade receivables	
Diminution in value [of assets]	Impairment	
Fixed assets		Non-current assets (although non-current assets is broader and includes eg debtors due after more than one year and deferred tax assets)
Group [accounts]	Consolidated [financial statements]	
IAS	EU-adopted IFRS	
Interest payable and similar charges	Finance costs	
Interest receivable and similar income	Finance income	
Parent undertaking	Parent	

^{*} The [draft] FRS requires the cash flow statement to reconcile the movement in 'cash and cash equivalents'. Disclosure is required of a reconciliation between amounts presented in the statement of financial position (ie cash) and 'cash and cash equivalents'.

Company law terminology	[Draft] FRS terminology	EU-adopted IFRS terminology (where different from [draft] FRS)
Profit and loss account	Income statement (If two statement approach) Part of the statement of comprehensive income (If one statement approach)	
Related undertakings	Subsidiaries, associates and joint ventures [*]	
Stocks [†]	Inventories	
Subsidiary undertaking	Subsidiary	
Tangible assets	Includes: Property, plant equipment; Investment property	
Trade creditors	Trade payables	
Turnover	Revenue	

^{*} This would also include entities in which a company has at least a 20% holding, but which is not a subsidiary, joint venture or an associate. A shareholding of 20% is presumed to give significant influence to the holder, such that the investment would be classified as an associate, therefore in practice there are unlikely to be many related undertakings that are not subsidiaries, joint ventures or associates.

[†] The Regulations require disclosure (either in on the face of the balance sheet or in the notes) of an analysis of stock between: 1.Raw materials and consumables; 2.Work in progress; and 3.Finished goods and goods for resale. The [draft] FRS only requires classifications appropriate to the entity, which therefore as a minimum must reconcile to the company law presentation.

APPENDIX III: NOTE ON THE LEGAL REQUIREMENTS IN THE UK AND REPUBLIC OF IRELAND

INTRODUCTION

- A3.1 This [draft] appendix provides an overview of how the proposals set out in this [draft] FRS address United Kingdom and Republic of Ireland company law requirements. It is therefore written from the perspective of a company to which the Companies Act 2006 applies. Specific legal requirements in the Republic of Ireland are available on the ASB website (www.frc.org.uk/asb).
- A3.2 Many entities that are not constituted as companies apply accounting standards promulgated by the ASB for the purposes of preparing financial statements that present a true and fair view. A brief consideration of the legal framework for some other entities can be found at A2.30. For those entities that are within the scope of a SORP, the relevant SORP will provide more details on the legal framework.
- A3.3 Reference to the Act in this Appendix refers to the Companies Act 2006. Reference to the Regulations refers to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. References to specific provisions are to Schedule 1 to the Regulations; entities applying Schedules 2, 3 or 6 should read them as referring to the equivalent paragraph in those schedules.

APPLICABLE ACCOUNTING FRAMEWORK

- A3.4 Entities, except those that are permitted to and elect to apply the small companies' regime, in accordance with the Act, or those that are required in accordance with the Act or voluntarily apply EU-adopted IFRS, apply FRS 102 (the Financial Reporting Standard applicable in the UK and Republic of Ireland).
- A3.5 Accounts prepared in accordance with EU-adopted IFRS are 'IAS accounts', and are within the scope of the IAS Regulation. All other accounts are classified as 'Companies Act accounts', and are therefore required to comply with the provisions of Part 15 of the Act and with the Regulations.

COMPANIES ACT ACCOUNTS

FINANCIAL INSTRUMENTS

- A3.6 All preparers of Companies Act accounts must comply with the prescriptive requirements of paragraph 36 of Schedule 1 to the Regulations*, which provides that:
- (1) Subject to sub-paragraphs (2) to (5), financial instruments (including derivatives) may be included at fair value.
 - (2) Sub-paragraph (1) does not apply to financial instruments that constitute liabilities unless—
 - a. they are held as part of a trading portfolio,
 - b. they are derivatives, or
 - c. they are financial instruments falling within sub-paragraph (4).

* *The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409) contain an identical provision for companies subject to the small companies' regime.*

(3) [...]

(4) Financial instruments that, under international accounting standards adopted by the European Commission on or before 5th September 2006 in accordance with the IAS Regulation, may be included in accounts at fair value, may be so included, provided that the disclosures required by such accounting standards are made.

(5) [...]

A3.7 An entity applying this [draft] FRS and holding financial instruments within the scope of Section 12 is required to hold non-basic financial instruments at fair value and comply with the disclosure requirement in paragraph 36(4) of Schedule 1 to the Regulations. This is achieved by providing the disclosures in paragraph 11.48A of this [draft] FRS. The disclosures in paragraph 11.48A apply to financial liabilities that are not held as part of a trading portfolio and are not derivatives.

APPLICATION OF THE [DRAFT] FRS 102

Compliance with UK and Irish company law

A3.8 The [draft] FRS has been developed for application in the UK and Republic of Ireland, using the IFRS for SMEs as a basis. Part of that development process included making amendments to the IFRS for SMEs to ensure compliance with the Act and the Regulations. For example, changes were made to eliminate options that are not permitted by company law. However, the [draft] FRS is not intended to be a one-stop-shop for all accounting and legal requirements, and although the Board believes the [draft] FRS is not inconsistent with company law, compliance with the [draft] FRS alone will often be insufficient to ensure compliance with all the disclosure requirements set out in the Act and the Regulations. As a result preparers will continue to be required to have regard to the requirements of company law in addition to accounting standards.

A3.9 This [draft] appendix does not list every legal requirement, but instead focuses on those areas where greater judgement might be required in determining compliance with the law.

Form and content of accounts

A3.10 The [draft] FRS does not prescribe which entities prepare financial statements and preparers should apply the requirements of the Act in determining whether financial statements (either individual or consolidated) are required. The [draft] FRS sets out the requirements for a complete set of financial statements that present fairly the financial position, financial performance and cash flows of an entity, where these are required by law, or other regulation or requirement.

A3.11 A parent company preparing consolidated financial statements under section 434(2) of the Act must publish its company financial statements together with the consolidated accounts, although section 408 of the Act allows an exemption from including the company profit and loss account in this case.

Investment entities excluded from consolidation

A3.12 The application of Section 9 'Consolidated and separate financial statements' paragraph 9.9(b) requires subsidiaries excluded from consolidation on the ground that they are held exclusively for resale and held as part of an investment portfolio to be included in the consolidated financial statement at fair value with changes in fair value recognised in profit or loss. The ASB gave careful consideration to whether it could permit subsidiaries held for investment purposes to be excluded from consolidation but decided that section 405(3) of the Act would not permit such treatment and that it was not possible to apply the true and fair override in these circumstances.

Reimbursement of provisions

- A3.13 The [draft] FRS, consistently with FRS 12 'Provisions, Contingent Liabilities and Contingent Assets', permits an expense relating to a provision to be presented net of the amount recognised for a reimbursement (which may only be recognised if it is virtually certain it will be received).
- A3.14 Paragraph 8 of Schedule 1 to the Regulations requires that 'Amounts in respect of items representing assets or income may not be set off against amounts in respect of items representing liabilities or expenditure (as the case may be), or vice versa.' The Board does not consider the net presentation, in the income statement, of a reimbursement to conflict with this requirement. The reimbursement asset is recognised separately from the underlying obligation, and the two are therefore not offset.

Recording investments at cost

- A3.15 Paragraph 9.26 of the [draft] FRS requires that in an investor's separate financial statements its investments in subsidiaries are accounted for at cost less impairment or at fair value. This limits the use of 'merger relief' and 'group reconstruction relief' as set out in sections 610–615 of the Act, so that although there continues to be a relief from transferring to the share premium account the excess of investment cost over nominal value of shares issued, the cost of the investment included in the balance sheet may not be reduced as would otherwise be permitted by section 615.

Realised profits

- A3.16 Paragraph 13(a) of Schedule 1 to the Regulations requires that only profits realised at the balance sheet date are included in the profit and loss account, a requirement modified from that in Article 31.1(c)(aa) of the Fourth Directive which refers to profits 'made' at the balance sheet date.
- A3.17 Paragraph 39 of Schedule 1 to the Regulations allows that investment property and living animals and plants that may under international accounting standards be held at fair value, may also be held at fair value in Companies Act accounts.
- A3.18 Paragraph 40(2) Schedule 1 to the Regulations then requires that movements in the value of such assets are recognised in the profit and loss account, notwithstanding the usual restrictions allowing only realised profits and losses to be included in the profit and loss account. Paragraph 40 of Schedule 1 to the Regulations thereby overrides the requirements of Paragraph 13(a) of Schedule 1 permitting the change in fair value to be included in the profit and loss account.
- A3.19 Entities measuring investment properties or living animals or plants at fair value should also note that while the [draft] FRS requires fair value movements to be shown in profit or loss they may transfer such amounts to a revaluation reserve but are not required to do so. Transferring amounts to a revaluation reserve may assist an entity in recording profits available for distribution in accordance with section 830 of the Act.

Merger accounting

- A3.20 Paragraph 10 of Schedule 6 to the Regulations permits the use of merger accounting in certain circumstances. The [draft] FRS requires the application of the purchase method of accounting for all acquisitions within the scope of Section 19, other than combinations of entities or businesses under common control. Paragraph 19.27 permits merger accounting for combinations of entities or businesses that are under common control. The [draft] FRS therefore restricts the circumstances in which merger accounting may be applied.

ACCOUNTS FORMATS

A3.21 Paragraph 3.17 of the [draft] FRS specifies the minimum components of a set of financial statements, including:

- (a) a **statement of financial position** as at the **reporting date**.
- (b) either:
 - (i) a single **statement of comprehensive income** for the reporting period displaying all items of income and expense recognised during the period including those items recognised in determining **profit or loss** (which is a subtotal in the statement of comprehensive income) and items of **other comprehensive income**, or
 - (ii) a separate **income statement** and a separate statement of comprehensive income. If an entity chooses to present both an income statement and a statement of comprehensive income, the statement of comprehensive income begins with profit or loss and then displays the items of other comprehensive income.
- (c) a **statement of changes in equity** for the reporting period.
- (d) a **statement of cash flows** for the reporting period.
- (e) **notes**, comprising a summary of significant accounting policies and other explanatory information.

A3.22 Paragraph 3.22 of the [draft] FRS then goes on to clarify that alternative titles may be used, providing that they are not misleading.

A3.23 Sections 4 and 5 of the [draft] FRS require entities to apply the profit and loss account and balance sheet formats set out in the Regulations, when preparing their statement of comprehensive income and statement of financial position.

Discontinued operations

A3.24 The [draft] FRS requires an entity with discontinued operations, to provide an analysis between continuing operations and discontinued operations of each of the line items on the face of the statement of comprehensive income, or income statement and statement of comprehensive income, and illustrates this in a columnar format. This is in order to present the post-tax results of those operations, combined with the profit or loss on their disposal, as a single line item while still complying with the requirement of company law to show totals for ordinary activities of items such as turnover*, profit or loss before taxation and tax.

Long-term debtors

A3.25 Preparers should also continue to note the distinction between 'fixed assets' (the term used in the Regulations) and 'non-current assets' (from EU-adopted IFRS). UITF Abstract 4 addressed the inclusion of debtors due after more than one year within 'current assets': that UITF consensus remains valid and is reproduced below.

A3.26 In most cases it will be satisfactory to disclose the size of debtors due after more than one year in the notes to the accounts. There will be some instances, however, where the amount is so material in the context of the total net current assets that in the absence of disclosure of the debtors due after more than one year on the face of the balance sheet readers may misinterpret

* Note that total turnover on ordinary activities is, of course, after deduction of trade discounts, value added tax and any other taxes based on such amounts.

the accounts. In such circumstances, the amount should be disclosed on the face of the balance sheet within current assets.

IMPACT ON DISTRIBUTABLE PROFITS

A3.27 The determination of profits available for distribution is a complex area where accounting and company law interface. In determining profits available for distribution an entity may refer to 'Guidance on realised and distributable profits under the Companies Act 2006' issued by the Institute of Chartered Accountants in England and Wales and the Institute of Chartered Accountants in Scotland.

A3.28 Areas where the application of the [draft] FRS could have an impact on distributable profits include the accounting for an entity's participation in a group defined benefit plan and the recognition of deferred tax on revaluations.

ENTITIES NOT SUBJECT TO COMPANY LAW

A3.29 Many entities that apply the [draft] FRS are not companies, but are nevertheless required by their governing legislation, or other regulation or requirement to prepare financial statements that present a true and fair view of the financial performance and financial position of the reporting entity. However, the Board sets accounting standards within the framework of the Act and therefore it is the company law requirements that the Board primarily considered when developing the [draft] FRS. Entities preparing financial statements within other legal frameworks will need to satisfy themselves that the [draft] FRS does not conflict with any relevant legal obligations.

A3.30 However, the Board notes the following:

Legislation	Overview of requirements
Building Societies Act 1986	<p>The annual accounts of a building society shall give a true and fair of the income and expenditure for the year and the balance sheet shall give a true and fair view of the state of affairs of the society at the end of the financial year.</p> <p>Regulations make further requirements about the form and content of building society accounts, which do not appear inconsistent with the requirement of [draft] FRS 102.</p>
Charities Act 1993 (as amended by the Charities Act 2006) and regulations made thereunder	<p>All charities are required to prepare accounts. The regulations require financial statements (other than cash-based receipts and payments accounts prepared by smaller charities) to present a true and fair view of the incoming resources, application of resources and the balance sheet, and to be prepared in accordance with the SORP.</p> <p>The Charities SORP 2005 requires the application of accounting standards and is compatible with the legal requirements, clarifying how they apply to accounting by charities. The SORP will be updated to reflect the requirements of the [draft] FRS.</p> <p>Company law prohibits charities from preparing IAS accounts.</p>
Friendly and Industrial and Provident Societies Act 1968	<p>Every Society shall prepare a revenue account and a balance sheet giving a true and fair view of the income and expenditure and state of affairs of the Society.</p> <p>The [draft] FRS does not appear to give rise to any legal conflicts for Societies. However, Societies often carry out activities that are regulated and may be required to comply with</p>

	additional regulations on top of the legal requirements and accounting standards. Some Societies fall within the scope of SORPs, which will be updated to reflect the requirements of the [draft] FRS.
The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996	The accounts of pension funds within the scope of the regulations should show a true and fair view of the transactions during the year, assets held at the end of the year and liabilities of the scheme, other than those to pay pensions and benefits. [draft] FRS 102 includes pension funds as a specialised activity.

APPENDIX IV: DEVELOPMENT OF [DRAFT] FRS 102

A4.1 The development of the proposals in this [draft] FRS is set out in part III of FREDs 46 to 48.

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