

**IASB PROPOSALS TO AMEND
CERTAIN INTERNATIONAL
ACCOUNTING STANDARDS**



**ACCOUNTING
STANDARDS
BOARD**

CONSULTATION PAPER

For the convenience of respondents in compiling their responses, the text of the questions on which particular comments are invited can be downloaded (in Word format) from the 'Consultation Paper May 2002' page in the Current Projects section of the ASB Website (www.asb.org.uk).

For ease of handling, we prefer comments to be sent (in Word format) by email to:

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Comments should be despatched so as to be received no later than 16 September 2002. All replies will be regarded as on the public record and may be copied to the IASB and other standard-setters, unless confidentiality is requested by the commentator.

**IASB PROPOSALS TO AMEND
CERTAIN INTERNATIONAL
ACCOUNTING STANDARDS**



**ACCOUNTING
STANDARDS
BOARD**

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PREFACE

- 1 This Consultation Paper is issued as part of the Accounting Standards Board's programme to bring about convergence between UK Accounting Standards and International Financial Reporting Standards (IFRSs^{*}). It sets out, for UK consultation, proposed amendments to six standards recently issued by the International Accounting Standards Board (IASB).
- 2 EU Ministers have proposed that from 1 January 2005, all listed companies in the EU should prepare their consolidated financial statements in accordance with adopted international accounting standards. A draft Regulation to this effect is at a late stage of negotiation and EU Ministers are expected to approve it shortly. The intention is that IFRSs will form the basis of those adopted international accounting standards.
- 3 After wide discussion with interested parties, the ASB has indicated its intention to pursue a programme of work to align UK accounting standards with IFRSs wherever practicable. The effect of this is that the substance of IFRSs will apply in the UK not only to the group financial statements of listed companies but also to individual financial statements and unlisted companies. However, the ASB will consider the option of retaining a UK standard, or modifying an IFRS in its wider application, for example if it appears likely that the cost of extending an unmodified IFRS more widely would exceed the benefit.

^{*} The IASB intends to designate its future standards as International Financial Reporting Standards, or IFRSs. Standards issued prior to 2002 are identified as International Accounting Standards, or IASs. In this Preface, the term IFRS is used to refer to both IFRSs and IASs.

- 4 The Government has said that it may wish to extend the Regulation to individual financial statements and unlisted companies from 2005 or later. Ministers intend to consult on this once the Regulation is agreed.
- 5 The IASB has recently published an exposure draft 'Improvements to International Accounting Standards', which proposes revisions to twelve standards. The ASB has published proposals to issue UK standards based on a number of these. This consultation document reproduces the IASB's text in respect of the remaining six IFRSs proposed for revision. For the reasons explained in this Preface, the ASB is not proposing to implement these standards in the UK before 2005; however, it is requesting comments on the IASB's proposed improvements and on any other aspects of the standards that the ASB should request the IASB to review.
- 6 The six IFRSs addressed in this consultation document are:
 - IAS 1 'Presentation of Financial Statements'.
 - IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.
 - IAS 17 'Leases'.
 - IAS 27 'Consolidated and Separate Financial Statements'.
 - IAS 28 'Accounting for Investments in Associates'.
 - IAS 40 'Investment Property'.

- 7 The IASB has presented the proposed improvements to these standards in different ways according to the extent of the proposed changes to the IFRSs. IAS 1 and 8 are presented as clean copies of the full revised texts. IAS 27 and 28 are presented as marked-up copies of the full revised texts, with the proposed changes identified by underlining new text and strikethrough of text to be deleted. For IAS 17 and 40, only marked-up versions of a limited number of paragraphs proposed for revision are presented.

**IAS 1 ‘Presentation of Financial Statements’ and
IAS 8 ‘Accounting Policies, Changes in Accounting
Estimates and Errors’**

- 8 IAS 1 sets out overall considerations for the presentation of financial statements, guidelines for their structure and minimum requirements for the content of financial statements. It deals with accounting principles (for example, going concern and the accruals basis of accounting) and the structure and content of the balance sheet, income statement, statement of changes in equity and notes to the financial statements.
- 9 IAS 8 sets out the criteria for selecting accounting policies. It also deals with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and errors.
- 10 At present, IAS 8 is titled ‘Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies’. The proposed change for the revised standard reflects the fact that the IASB has proposed moving a number of requirements from IAS 1 to IAS 8 and vice-versa.

- 11 In UK accounting, FRS 3 ‘Reporting Financial Performance’, FRS 18 ‘Accounting Policies’ and the Companies Act (in particular, Schedule 4) cover broadly the same ground as IAS 1 and IAS 8.

- 12 There are a number of reasons why the ASB does not propose to issue UK standards based on IAS 1 and IAS 8 at this time:
 - IAS 1, and potentially parts of IAS 8, seem likely to change further as a result of the ongoing IASB/ASB joint project on performance reporting.
 - Due to the fundamental nature of both standards, implementation would be extremely difficult in advance of full implementation of IFRSS in the UK.
 - In order to implement much of IAS 1, changes to the Companies Act would be required.

- 13 The main changes to the present standards proposed by the IASB are summarised on pages 16-18 and 71-73. The most significant in a UK context are the following:
 - (a) IAS 1 sets out the overriding requirement that financial statements should ‘present fairly’ the financial position, financial performance and cash flows of an entity. The exposure draft includes additional guidance on the meaning of ‘present fairly’ and emphasises that compliance with the requirements of applicable IFRSS or of Interpretations of IFRSS (with additional disclosure where necessary) is presumed to result in financial statements that achieve a fair presentation.

The exposure draft requires an entity to depart from a requirement of an IFRS in the extremely rare circumstances in which management concludes that compliance with the requirement would be so misleading that it would conflict with the objective of financial statements set out in the IASB's 'Framework for the Preparation and Presentation of Financial Statements'*. The requirement to depart from an IFRS in such circumstances is subject to the relevant regulatory framework either requiring or otherwise not prohibiting departure. Where an entity departs from the requirements of an IFRS, the disclosure requirements are similar to those required by FRS 18 in respect of a 'true and fair override' of an FRS.

The ASB has strongly supported the principle of a 'true and fair override' in IFRSS.

- (b) A proposed change to IAS 8 removes the distinction between fundamental and other errors. Under the revised standard, all material errors would be accounted for retrospectively, by restating the comparative amounts for the period in which the error occurred. In UK accounting standards, FRS 3 requires that only fundamental errors are accounted for in this way (ie by way of a 'prior period adjustment'), with other material errors accounted for in the current period.
- (c) Other proposed changes would bring the IFRSS into line with UK accounting standards in relation to extraordinary items (prohibited) and changes in accounting policy (always accounted for by way of a prior period adjustment).

* *The objective of financial statements is stated to be "to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions".*

- 14 The full text of the proposed IFRSs is set out on pages 11 to 90.

IAS 27 ‘Consolidated and Separate Financial Statements’ and IAS 28 ‘Accounting for Investments in Associates’

- 15 IAS 27 sets out the requirements to be applied in the preparation and presentation of consolidated financial statements for a group. It also deals with the treatment of investments in subsidiaries, jointly controlled entities and associates in the separate financial statements of a parent, venturer or investor. IAS 28 deals with the requirements to be applied by an investor in accounting for investments in associates.
- 16 In UK accounting standards, FRS 2 ‘Accounting for subsidiary undertakings’ and FRS 9 ‘Associates and joint ventures’ cover the same ground as the international standards.
- 17 The ASB does not propose to issue UK standards based on IAS 27 and IAS 28 at this time, as both standards seem likely to change as a result of further IASB projects that are expected to address the requirements for consolidation.
- 18 The main changes to IAS 27 and IAS 28 proposed by the IASB are summarised on pages 109-110 and 135-136. They are not fundamental to either standard, addressing issues such as:
- The circumstances in which intermediate parents are exempt from preparing consolidated financial statements.

- The treatment of investments in subsidiaries, associates and jointly controlled entities in an investor's separate financial statements (the proposed revision would require such investments to be carried at cost or accounted for in accordance with IAS 39 'Financial Instruments: Recognition and Measurement').*
 - The effect of severe and long-term restrictions which significantly affect a subsidiary's ability to transfer funds to its parent.
 - The presentation of minority interests.
 - The use of the equity method for an investment in an associate when an investor does not prepare consolidated financial statements.
 - The exclusion of investments by venture capital organisations, mutual funds, unit trusts and similar entities from the scope of IAS 28 (and IAS 31, Financial Reporting of Interests in Joint Ventures), when they are measured at fair value.
 - The assets to be written down when an associate incurs losses.
- 19 The full text of the proposed IFRSs is set out on pages 105 to 154 and the proposed changes to the existing international standards are identified using revision marks.

* This is the reason for the addition of the words "...and Separate Financial Statements" to the title of the proposed revised IAS 27.

IAS 17 ‘Leases’ and IAS 40 ‘Investment Property’

- 20 The IASB is proposing only a small number of specific amendments to the standards on leasing and investment property. These are:
- In the financial statements of lessors, to require that initial direct costs incurred in negotiating and arranging leases should be capitalised and charged as expenses over the lease term.
 - For leases of land and buildings, to require that the land and the buildings elements be considered separately when classifying the lease as a finance lease or an operating lease.
 - To amend the definition of an investment property in IAS 40 to remove the anomaly that precludes investments in long-term property leases (that are technically operating leases) from being treated as investment properties. A lessee that classifies a property interest held under an operating lease as investment property would be required to account for the lease as if it were a finance lease.
- 21 The marked-up texts of the paragraphs in IAS 17 and IAS 40 that are proposed for revision are set out on pages 97-101 and 161-163 respectively.
- 22 IAS 17 is expected to undergo a more fundamental review and so the ASB does not propose to implement this revised standard in the UK.

- 23 IAS 40 presently allows a choice of measuring investment properties at fair value or depreciated cost. Under the fair value model, gains and losses on revaluation are taken to income (under UK accounting requirements they are generally recognised in the statement of total recognised gains and losses). The IASB has considered whether the present choice of measurement basis should be removed, but decided against addressing this in the improvements project. It decided, however, to keep the matter under review, with a view to reconsidering the option to use the cost model in due course. In view of this and the implications for reporting performance, the ASB does not propose to replace SSAP 19 with IAS 40 at this time.

Questions for respondents

- 24 The ASB is requesting comments by 16 September 2002—the same date as the IASB has set for comments on its proposed revisions to the standards.
- 25 Comments are invited on any aspect of the Consultation Paper and, in particular, on the questions raised by the IASB on the proposed changes to IASs 1, 8, 17, 27, 28 and 40 (reproduced on pages 14-15, 70, 94, 108, 134 and 158 of the Paper, respectively).
- 26 Are there any other aspects of the proposed revised standards that the ASB should request the IASB to review when finalising them?

**Proposed Improvements to
International Accounting Standard IAS 1
(revised 1997)**

Presentation of Financial Statements

International Accounting Standard IAS 1

(revised 200X)

Presentation of Financial Statements

Invitation to Comment

The Board would particularly welcome answers to the questions set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Question 1

Do you agree with the proposed approach regarding departure from a requirement of an International Financial Reporting Standard or an Interpretation of an International Financial Reporting Standard to achieve a fair presentation (see proposed paragraphs 13-16)?

Question 2

Do you agree with prohibiting the presentation of items of income and expense as extraordinary items in the income statement and the notes (see proposed paragraphs 78 and 79)?

Question 3

Do you agree that a long-term financial liability due to be settled within twelve months of the balance sheet date should be classified as a current liability, even if an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue (see proposed paragraph 60)?

Question 4

Do you agree that:

- (a) a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date, even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach (see proposed paragraph 62)?

- (b) if a lender was entitled to demand immediate repayment of a loan because the entity breached a condition of its loan agreement, but agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and:
- (i) the entity rectifies the breach within the period of grace; or
 - (ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified (see proposed paragraphs 63 and 64)?

Question 5

Do you agree that an entity should disclose the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements (see proposed paragraphs 108 and 109)?

Question 6

Do you agree that an entity should disclose key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year (see proposed paragraphs 110-115)?

Summary of Main Changes

The main changes proposed are:

- to include in paragraph 10 guidance on the meaning of present fairly and to emphasise that the application of International Financial Reporting Standards and Interpretations of those Standards is presumed to result in financial statements that achieve a fair presentation.
- to specify in proposed paragraphs 13-16 that in the extremely rare circumstances in which management concludes that compliance with a requirement in an International Financial Reporting Standard or an Interpretation of a Standard would be so misleading that it would conflict with the objective of financial statements set out in the Framework for the Preparation and Presentation of Financial Statements:
 - if the relevant regulatory framework requires or otherwise does not prohibit a departure from the requirement, the entity makes that departure and the disclosures set out in proposed paragraph 14; and
 - if the relevant regulatory framework prohibits departure from the requirement, the entity reduces, to the maximum extent possible, the perceived misleading aspects of compliance by making the disclosures set out in proposed paragraph 15.
- to transfer paragraphs 20-22, which relate to the selection and application of accounting policies, to IAS 8.
- to amend the basis for exemption from disclosing particular items of comparative information from impracticability to causing undue cost or effort . This amendment affects proposed paragraphs 35-38.
- to amend paragraph 53 to specify that an entity uses a liquidity presentation of assets and liabilities, instead of a current/non-current presentation, only when a liquidity presentation provides more relevant and reliable information (see proposed paragraph 49).
- to amend paragraph 63 to specify that a long-term financial liability due to be settled within twelve months of the balance sheet date should be classified as a current liability, even if an agreement to refinance, or to

reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue (see proposed paragraph 60). This amendment does not affect the classification of a liability as non-current when the entity has, under the terms of an existing loan facility, the discretion to refinance or roll over its obligations for at least twelve months after the balance sheet date (as discussed in proposed paragraph 61).

- to amend paragraph 65 to specify that a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach (see proposed paragraph 62). However, proposed paragraph 63 states that if the lender has agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and:
 - the entity rectifies the breach within the period of grace; or
 - when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified.
- to extend paragraphs 66 and 75 to include all requirements currently set out in other Standards for the presentation of particular line items on the face of the balance sheet and income statement (see proposed paragraphs 65 and 76). Consequently, those requirements would be removed from other Standards.
- to transfer to this Standard from IAS 8 the section that sets out the presentation requirements for the net profit or loss for the period (IAS 8, paragraphs 7-10: see proposed paragraphs 73-75).

- to remove requirements for the following disclosures:
 - the results of operating activities, as a line item on the face of the income statement (paragraph 75(b)). Operating activities are not defined in IAS 1.
 - extraordinary items, as a line item on the face of the income statement (paragraph 75(g)). Proposed paragraphs 78 and 79 are added to specify that disclosure of extraordinary items is prohibited in financial statements.
 - an entity's country of incorporation and the address of its registered office (paragraph 102(a)).
 - the number of an entity's employees (paragraph 102(d)).
- to add proposed paragraphs 108 and 109, to require disclosure of the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements.
- to add proposed paragraphs 110-115, to require disclosure of key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

This Exposure Draft proposes extensive changes to IAS 1. Hence, for ease of reading, it is presented as a clean draft rather than a marked-up version that marks the changes.

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International Accounting Standard IAS 1 (revised 200X)

Presentation of Financial Statements

The standards, which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the Preface to International Accounting Standards. International Accounting Standards are not intended to apply to immaterial items (see paragraph 12 of the Preface).

Objective

The objective of this Standard is to prescribe the basis for presentation of general purpose financial statements, to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. To achieve this objective, this Standard sets out overall considerations for the presentation of financial statements, guidelines for their structure and minimum requirements for the content of financial statements. The recognition, measurement and disclosure of specific transactions and other events is dealt with in other Standards.

Scope

- 1. This Standard shall be applied in the presentation of all general purpose financial statements prepared and presented in accordance with International Financial Reporting Standards.***
- General purpose financial statements are those intended to meet the needs of users who are not in a position to demand reports tailored to meet their specific information needs. General purpose financial statements include those that are presented separately or within another public document such as an annual report or a prospectus. This Standard does not apply to condensed interim financial information. When a group of entities exists, this Standard applies equally to the separate financial statements of a member of the group and to the consolidated financial statements for the group, as referred to in IAS 27, Consolidated and Separate Financial Statements.

3. This Standard applies to all types of entities, including banks and insurance entities. Additional requirements for banks and similar financial institutions, consistent with the requirements of this Standard, are set out in IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions.
4. This Standard uses terminology that is suitable for a profit-oriented entity. Public sector business enterprises may therefore apply the requirements of this Standard. Entities with not-for-profit activities in the private sector, public sector or government seeking to apply this Standard may need to amend the descriptions used for particular line items in the financial statements and for the financial statements themselves.

Purpose of Financial Statements

5. Financial statements are a structured representation of the financial position of an entity, the transactions undertaken by an entity and other events affecting it. The objective of general purpose financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of management's stewardship of the resources entrusted to it. To meet this objective, financial statements provide information about an entity's:
 - (a) assets;
 - (b) liabilities;
 - (c) equity;
 - (d) income and expenses, including gains and losses;
 - (e) other changes in equity; and
 - (f) cash flows.

This information, along with other information in the notes to financial statements, assists users in predicting the entity's future cash flows and, in particular, the timing and certainty of the generation of cash and cash equivalents.

Components of Financial Statements

6. *A complete set of financial statements includes the following components:*
 - (a) *a balance sheet;*
 - (b) *an income statement;*
 - (c) *a statement of changes in equity showing either:*
 - (i) *all changes in equity, or*
 - (ii) *changes in equity other than those arising from capital transactions with owners and distributions to owners;*
 - (d) *a cash flow statement; and*
 - (e) *a summary of significant accounting policies and other explanatory notes.*

7. Many entities present, outside the financial statements, a financial review by management that describes and explains the main features of the entity's financial performance and financial position and the principal uncertainties it faces. Such a report may include a review of:
 - (a) the main factors and influences determining financial performance, including changes in the environment in which the entity operates, the entity's response to those changes and their effect, and the entity's policy for investment to maintain and enhance financial performance, including its dividend policy;
 - (b) the entity's sources of funding, its policy on gearing and its risk management policies; and

- (c) the resources of the entity whose value is not recognised in the balance sheet under International Financial Reporting Standards.
- 8. Many entities present, outside the financial statements, additional statements such as environmental reports and value added statements, particularly in industries where environmental factors are significant and when employees are regarded as an important user group.
- 9. The reports and statements described in paragraphs 7 and 8 are outside the scope of International Financial Reporting Standards.

Overall Considerations

Fair Presentation and Compliance with International Financial Reporting Standards and Interpretations of those Standards

- 10. Financial statements shall present fairly the financial position, financial performance and cash flows of an entity (that is, represent faithfully the effects of transactions and other events in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework for the Preparation and Presentation of Financial Statements). The application of International Financial Reporting Standards and Interpretations of those Standards, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.*
- 11. An entity whose financial statements comply with International Financial Reporting Standards and Interpretations of those Standards shall disclose that fact. Financial statements shall not be described as complying with International Financial Reporting Standards and Interpretations of those Standards unless they comply with all the requirements of each applicable Standard and Interpretation.*
- 12. In virtually all circumstances, a fair presentation is achieved by compliance with applicable International Financial Reporting Standards and Interpretations of those Standards. A fair presentation requires:

- (a) selecting and applying accounting policies in accordance with IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors. IAS 8 specifies a hierarchy of authoritative guidance that management considers in the absence of a Standard or an Interpretation specifically applying to an item;
 - (b) presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and
 - (c) providing additional disclosures when the particular requirements in International Financial Reporting Standards and Interpretations of those Standards are insufficient to enable users to understand the impact of particular transactions or other events on the entity's financial position and financial performance.
- 13. *In the extremely rare circumstances in which management concludes that compliance with a requirement in an International Financial Reporting Standard or an Interpretation of a Standard would be so misleading that it would conflict with the objective of financial statements set out in the Framework, the entity shall depart from that requirement in the manner set out in paragraph 14 if the relevant regulatory framework requires or otherwise does not prohibit such a departure.***
- 14. *When an entity departs from a requirement of an International Financial Reporting Standard or an Interpretation of a Standard under paragraph 13, it shall disclose:***
- (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 applicable International Financial Reporting Standards and Interpretations of those Standards, except that it has departed from a requirement of a Standard or an Interpretation to achieve a fair presentation;***

- (c) *the Standard or Interpretation from which the entity has departed, the nature of the departure, including the treatment that the Standard or Interpretation 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 the Framework, and the treatment adopted; and*
 - (d) *for each period presented, the financial impact of the departure on each item in the financial statements that would have been reported in complying with the requirement.*
15. *In the extremely rare circumstances in which management concludes that compliance with a requirement in an International Financial Reporting Standard or an Interpretation of a Standard would be so misleading that it would conflict with the objective of financial statements set out in the Framework, and the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing:*
- (a) *the Standard or Interpretation requiring the entity to report information concluded to be misleading, the nature of the requirement, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of financial statements set out in the Framework; and*
 - (b) *for each period presented, the adjustments to each item in the financial statements that management has concluded would be necessary to achieve a fair presentation.*
16. For the purposes of paragraphs 13-15, an item of information would conflict with the objective of financial statements when it does not represent faithfully the transactions or other events that it either purports to represent or could reasonably be expected to represent and,

consequently, it would be likely to affect adversely economic decisions made by users of financial statements. When assessing whether complying with a specific requirement in an International Financial Reporting Standard or an Interpretation of a Standard would be so misleading that it would conflict with the objective of financial statements set out in the Framework, consideration is given to:

- (a) why the objective of financial statements is not achieved in the particular circumstances; and
- (b) the way in which the entity's circumstances differ from those of other entities that comply with the requirement. There is a rebuttable presumption that if other entities in similar circumstances comply with the requirement, the entity's compliance with the requirement would not be so misleading that it would conflict with the objective of financial statements set out in the Framework.

17. When, in accordance with specific provisions in that Standard, an International Financial Reporting Standard is applied before its effective date, that fact shall be disclosed.

Going Concern

18. When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. Financial statements shall be prepared on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, those uncertainties shall be disclosed. When the financial statements are not prepared on a going concern basis, that fact shall be disclosed, together with the basis on which the financial statements are prepared and the reason why the entity is not regarded as a going concern.

19. 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 balance sheet date. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, a conclusion that the going concern basis of accounting is appropriate may be reached without detailed analysis. In other cases, management may need to consider a wide range of factors surrounding current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

Accrual Basis of Accounting

20. *An entity shall prepare its financial statements, except for cash flow information, under the accrual basis of accounting.*
21. Under the accrual basis of accounting, items are recognised as assets, liabilities, equity, income and expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements set out in the Framework for the Preparation and Presentation of Financial Statements.

Consistency of Presentation

22. *The presentation and classification of items in the financial statements shall be retained from one period to the next unless:*
- (a) *a significant change in the nature of the operations of the entity or a review of its financial statement presentation demonstrates that a change in presentation results in a more appropriate presentation of transactions or other events; or*
 - (b) *a change in presentation is required by an International Financial Reporting Standard or an Interpretation of a Standard.*

23. A significant acquisition or disposal, or a review of the financial statements presentation, might suggest that the financial statements need to be presented differently. Only if the revised structure is likely to continue, or if the benefit of an alternative presentation is clear, does an entity change the presentation of its financial statements. When such changes in presentation are made, an entity reclassifies its comparative information in accordance with paragraphs 35 and 36.

Materiality and Aggregation

24. *Each material class of similar items shall be presented separately in the financial statements. Immaterial amounts can be aggregated with amounts of classes of different items, and need not be presented separately.*
25. Financial statements result from processing large numbers of recognised 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 on the face of the financial statements or in the notes. If a line item is not individually material, it is aggregated with other items either on the face of the financial statements or in the notes. An item that is not sufficiently material to warrant separate presentation on the face of the financial statements may nevertheless be sufficiently material for it to be presented separately in the notes.
26. In this context, information is material if its non-disclosure could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the item or aggregation of items judged in the particular circumstances of its omission. In deciding whether an item or an aggregation of items is material, the nature and the size of the item or items are evaluated together. Depending on the circumstances, the nature or the size of the item or items could be the determining factor. For example, individual assets with the same nature and function are aggregated into the same class even if the individual amounts are large. However, large items that differ in nature or function are presented separately.

27. Applying the concept of materiality means that the specific disclosure requirements of International Financial Reporting Standards and Interpretations of those Standards need not be met if the resulting information is not material.

Offsetting

- 28. *Assets and liabilities shall not be offset except when offsetting is required by another Standard.***
- 29. *Items of income and expense shall be offset when, and only when, a Standard requires or permits it.***
30. It is important that assets and liabilities, and income and expenses, when material, are reported separately. Offsetting in the income statement or the balance sheet, except when offsetting reflects the substance of the transaction or other event, detracts from the ability of users to understand the transactions undertaken and to assess the future cash flows of the entity. The reporting of assets net of valuation allowances for example, obsolescence allowances on inventories and doubtful debts allowances on receivables is not offsetting.
31. IAS 18, Revenue, defines revenue and requires it to be measured at the fair value of the consideration received or receivable, taking into account the amount of any trade discounts and volume rebates allowed by the entity. An entity undertakes, in the course of its ordinary activities, other transactions that do not generate revenue but are incidental to the main revenue-generating activities. The results of such transactions are presented, when this presentation reflects the substance of the transaction or other event, by netting any income with related expenses arising on the same transaction. For example:
- (a) gains and losses on the disposal of non-current assets, including investments and operating assets, are reported by deducting from the proceeds on disposal the carrying amount of the asset and related selling expenses; and
 - (b) expenditure that is reimbursed under a contractual arrangement with a third party (for example, a subletting agreement) is netted against the related reimbursement.

32. In addition, gains and losses arising from a group of similar transactions are reported on a net basis, for example, foreign exchange gains and losses or gains and losses arising on financial instruments held for trading purposes. Such gains and losses are, however, reported separately if their size, nature or incidence is such that separate disclosure is required by paragraph 80.

Comparative Information

33. *Unless an International Financial Reporting Standard permits or requires otherwise, comparative information shall be disclosed in respect of the previous period for all amounts reported in the financial statements. Comparative information shall be included for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.*

34. In some cases narrative information provided in the financial statements for the previous period(s) continues to be relevant in the current period. For example, details of a legal dispute, the outcome of which was uncertain at the last balance sheet date and is yet to be resolved, are disclosed in the current period. Users benefit from information that the uncertainty existed at the last balance sheet date, and about the steps that have been taken during the period to resolve the uncertainty.

35. *When the presentation or classification of items in the financial statements is amended, comparative amounts shall be reclassified unless the reclassification would require undue cost or effort. When comparative amounts are reclassified, an entity shall disclose:*

- (a) the nature of the reclassification;*
- (b) the amount of each item or class of items that is reclassified; and*
- (c) the reason for the reclassification.*

36. *When reclassifying comparative amounts would require undue cost or effort, an entity shall disclose:*
- (a) the reason for not reclassifying the amounts; and*
 - (b) the nature of the adjustments that would have been made if the amounts were reclassified.*
37. Enhancing the inter-period comparability of information assists users in making economic decisions, especially by allowing the assessment of trends in financial information for predictive purposes. There is a general presumption, therefore, that the benefits from reclassifying comparative information exceed the resulting cost or effort and, accordingly, that an entity would make every reasonable effort to reclassify comparative amounts for each prior period presented.
38. In some circumstances, the cost or effort of reclassifying comparative information for a particular prior period to achieve comparability with the current period would exceed the resulting benefits to be derived by users of the financial statements. For example, data may not have been collected in the prior period(s) in a way that allows reclassification, and recreating the information would require undue cost or effort. In such circumstances, an entity discloses the reason for not reclassifying the comparative amounts and the nature of the adjustments to comparative amounts that would have been made.
39. IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, deals with the adjustments to comparative information required following a change in an accounting policy.

Structure and Content

Introduction

40. This Standard requires particular disclosures on the face of the financial statements and requires other line items to be disclosed either on the face of the financial statements or in the notes. IAS 7 sets out requirements for the presentation of a cash flow statement.

41. This Standard sometimes uses the term disclosure in a broad sense, encompassing items presented on the face of each financial statement as well as in the notes to the financial statements. Disclosures also are required by other International Financial Reporting Standards and Interpretations of those Standards. Unless specified to the contrary in this Standard, another Standard or an Interpretation of a Standard, such disclosures are made on the face of the relevant financial statement or in the notes.

Identification of Financial Statements

42. *Financial statements shall be identified clearly and distinguished from other information in the same published document.*
43. International Financial Reporting Standards and Interpretations of those Standards apply only to the financial statements, and not to other information presented in an annual report or other document. Therefore, it is important that users can distinguish information that is prepared using International Financial Reporting Standards and Interpretations of those Standards from other information that may be useful to users but is not the subject of those requirements.
44. *Each component of the financial statements shall be identified clearly. In addition, the following information shall be displayed prominently, and repeated when it is necessary for a proper understanding of the information presented:*
- (a) the name of the reporting entity or other means of identification, and any change in that information from the preceding balance sheet date;*
 - (b) whether the financial statements cover the individual entity or a group of entities;*
 - (c) the balance sheet date or the period covered by the financial statements, whichever is appropriate to the related component of the financial statements;*
 - (d) the presentation currency; and*

(e) the level of precision used in the presentation of amounts in the financial statements.

45. The requirements in paragraph 44 normally are met by presenting page headings and abbreviated column headings on each page of the financial statements. Judgement is required in determining the best way of presenting such information. For example, when the financial statements are presented electronically, separate pages may not be used; the above items are then presented frequently enough to ensure a proper understanding of the information given.
46. Financial statements often are made more understandable by presenting information in thousands or millions of units of the presentation currency. This is acceptable as long as the level of precision in presentation is disclosed and relevant information is not omitted.

Reporting Period

47. Financial statements shall be presented at least annually. When an entity's balance sheet date changes and annual financial statements are presented for a period longer or shorter than one year, an entity shall disclose, in addition to the period covered by the financial statements:

(a) the reason for using a period other than one year; and

(b) the fact that comparative amounts for the income statement, changes in equity, cash flows and related notes are not comparable.

48. Normally, financial statements are consistently prepared covering a one-year period. However, for practical reasons, some entities prefer to report, for example, for a 52-week period. This Standard does not preclude this practice, because the resulting financial statements are unlikely to be materially different from those that would be presented for one year.

Balance Sheet

Current/Non-Current Distinction

49. *An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications on the face of its balance sheet in accordance with paragraphs 54-64 except when a liquidity presentation provides more relevant and reliable information. In such cases, all assets and liabilities shall be presented broadly in order of liquidity.*
50. *Whichever method of presentation is adopted, for each asset and liability line item that combines amounts expected to be recovered or settled within no more than twelve months after the balance sheet date and more than twelve months after the balance sheet date, an entity shall disclose the amount expected to be recovered or settled after more than twelve months.*
51. When an entity supplies goods or services within a clearly identifiable operating cycle, separate classification of current and non-current assets and liabilities on the face of the balance sheet provides useful information by distinguishing the net assets that are continuously circulating as working capital from those used in the entity's long-term operations. It also highlights assets that are expected to be realised within the current operating cycle, and liabilities that are due for settlement within the same period.
52. For some entities, such as financial institutions, a liquidity presentation of assets and liabilities provides more relevant and reliable information than a current/non-current presentation because the entity does not supply goods or services within a clearly identifiable operating cycle.
53. Information about expected dates of realisation of assets and liabilities is useful in assessing the liquidity and solvency of an entity. IAS 32, Financial Instruments: Disclosure and Presentation, requires disclosure of the maturity dates of financial assets and financial liabilities. Financial assets include trade and other receivables, and financial liabilities include

trade and other payables. Information on the expected date of recovery and settlement of non-monetary assets and liabilities such as inventories and provisions also is useful, whether or not assets and liabilities are classified as current or non-current. For example, an entity discloses the amount of inventories that are expected to be recovered after more than twelve months from the balance sheet date.

Current Assets

54. *An asset shall be classified as current when it:*

- (a) *is expected to be realised in, or is held for sale or consumption in, the normal course of the entity's operating cycle;***
- (b) *is held primarily for trading purposes;***
- (c) *is expected to be realised within twelve months of the balance sheet date; or***
- (d) *is cash or a cash equivalent asset that is not restricted from being exchanged or used to settle a liability for at least twelve months from the balance sheet date.***

All other assets shall be classified as non-current.

55. This Standard uses the term non-current to include tangible, intangible and financial assets of a long-term nature. It does not prohibit the use of alternative descriptions as long as the meaning is clear.
56. The operating cycle of an entity is the time between the acquisition of materials entering into a process and their realisation in cash or a cash equivalent asset. Current assets include inventories and trade receivables that are sold, consumed and realised as part of the normal operating cycle even when they are not expected to be realised within twelve months of the balance sheet date. Current assets also include the current portion of non-current financial assets. Marketable securities are classified as current if they are expected to be realised within twelve months of the balance sheet date; otherwise they are classified as non-current.

Current Liabilities

57. A liability shall be classified as current when it:

- (a) is expected to be settled in the normal course of the entity's operating cycle; or**
- (b) is due to be settled within twelve months of the balance sheet date.**

All other liabilities shall be classified as non-current.

58. Current liabilities can be categorised similarly to current assets. Some current liabilities, such as trade payables and accruals for employee and other operating costs, are part of the working capital used in the normal operating cycle of the business. Such operating items are classified as current liabilities even if they are due to be settled after more than twelve months from the balance sheet date.
59. Other current liabilities are not settled as part of the current operating cycle, but are due for settlement within twelve months of the balance sheet date. Examples are the current portion of non-current financial liabilities, bank overdrafts, dividends payable, income taxes and other non-trade payables. Financial liabilities that provide the financing for working capital on a long-term basis, and are not due for settlement within twelve months, are non-current liabilities.
60. An entity classifies its long-term financial liabilities as current when they are due to be settled within twelve months of the balance sheet date, even if:
- (a) the original term was for a period of more than twelve months; and
 - (b) an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue.

61. An obligation that an entity expects to refinance or roll over for at least twelve months after the balance sheet date under an existing loan facility is classified as non-current, even if it is otherwise due to be repaid within twelve months of the balance sheet date. However, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no agreement to refinance), the potential to refinance is not considered and the obligation is classified as current.
62. When an entity breaches an undertaking or covenant under a long-term loan agreement with the effect that the liability becomes payable on demand, the liability is classified as current at the balance sheet date, even if the lender has agreed, after the balance sheet date and before the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach.
63. However, if the lender has agreed by the balance sheet date to provide a period of grace within which the entity can rectify a breach of an undertaking or covenant under a long-term loan agreement and during that time the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of an undertaking or covenant, at least twelve months after the balance sheet date and:
- (a) the entity rectifies the breach within the period of grace; or
 - (b) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified.
64. In the circumstances described in paragraph 63, if the entity fails to rectify the breach within the period of grace, the failure confirms that, in substance, the loan was payable on demand at the balance sheet date and the liability is classified as current.

Information to be Presented on the Face of the Balance Sheet

65. *As a minimum, the face of the balance sheet shall include line items that present the following amounts:*
- (a) property, plant and equipment;*
 - (b) investment property;*
 - (c) intangible assets;*
 - (d) financial assets (excluding amounts shown under (e), (h) and (i));*
 - (e) investments accounted for using the equity method;*
 - (f) biological assets;*
 - (g) inventories;*
 - (h) trade and other receivables;*
 - (i) cash and cash equivalents;*
 - (j) trade and other payables;*
 - (k) provisions;*
 - (l) financial liabilities (excluding amounts shown under (j) and (k));*
 - (m) tax liabilities and assets;*
 - (n) minority interest; and*
 - (o) issued capital and reserves attributable to owners of the parent.*
66. *Additional line items, headings and subtotals shall be presented on the face of the balance sheet when such presentation is relevant to an understanding of the entity's financial position.*

67. This Standard does not prescribe the order or format in which items are to be presented. Paragraph 65 simply provides a list of items that are sufficiently different in nature or function that they warrant separate presentation on the face of the balance sheet. In addition:
- (a) line items are included when the size, nature or function of an item or aggregation of similar items is such that separate presentation is relevant to an understanding of the entity's financial position; and
 - (b) the descriptions used and the ordering of items or aggregation of similar items may be amended according to the nature of the entity and its transactions, to provide information that is relevant to an understanding of the entity's financial position. For example, a bank amends the above descriptions to apply the more specific requirements in IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions.
68. The judgement on whether additional items are presented separately is based on an assessment of:
- (a) the nature and liquidity of assets;
 - (b) the function of assets within the entity; and
 - (c) the amounts, nature and timing of liabilities.
69. The use of different measurement bases for different classes of assets suggests that their nature or function differs and, therefore, that they should be presented as separate line items. For example, different classes of property, plant and equipment can be carried at cost or revalued amounts in accordance with IAS 16, Property, Plant and Equipment.

Information to be Presented either on the Face of the Balance Sheet or in the Notes

- 70. *An entity shall disclose, either on the face of the balance sheet or in the notes, further subclassifications of the line items presented, classified in a manner appropriate to the entity's operations.***

71. The detail provided in subclassifications depends on the requirements of Standards and Interpretations of those Standards and on the size, nature and function of the amounts involved. The factors set out in paragraph 68 also are used to decide the basis of subclassification. The disclosures vary for each item, for example:

- (a) tangible assets are classified by class as described in IAS 16, Property, Plant and Equipment;
- (b) receivables are disaggregated into amounts receivable from trade customers, receivables from related parties, prepayments and other amounts;
- (c) inventories are subclassified, in accordance with IAS 2, Inventories, into classifications such as merchandise, production supplies, materials, work in progress and finished goods;
- (d) provisions are disaggregated into provisions for employee benefit costs and other items; and
- (e) equity capital and reserves are disaggregated into the various classes of paid-in capital, share premium and reserves.

72. *An entity shall disclose the following, either on the face of the balance sheet or in the notes:*

(a) for each class of share capital:

- (i) the number of shares authorised;*
- (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 subsidiaries or associates of the entity; and*
 - (vii) *shares reserved for issue under options and sales contracts, including the terms and amounts; and*
- (b) *a description of the nature and purpose of each reserve within equity.*

An entity without share capital, such as a partnership, shall disclose information equivalent to that required above, showing movements during the period in each category of equity interest, and the rights, preferences and restrictions attaching to each category of equity interest.

Income Statement

Profit or Loss for the Period

73. *All items of income and expense recognised in a period shall be included in the determination of profit or loss unless a Standard requires or permits otherwise.*
74. Normally, all items of income and expense recognised in a period are included in the determination of profit or loss. This includes the effects of changes in accounting estimates. However, circumstances may exist when particular items may be excluded from profit or loss for the current period. IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, deals with two such circumstances: the correction of errors and the effect of changes in accounting policies.

75. Other Standards deal with items that may meet the Framework definitions of income or expense but are usually excluded from the determination of profit or loss. Examples include revaluation surpluses (see IAS 16, Property, Plant and Equipment), gains and losses arising on the translation of the financial statements of a foreign operation (see IAS 21, The Effects of Changes in Foreign Exchange Rates) and gains or losses on remeasuring available-for-sale financial assets (see IAS 39, Financial Instruments: Recognition and Measurement).

Information to be Presented on the Face of the Income Statement

76. *As a minimum, the face of the income statement shall include line items that present the following amounts for the period:*

- (a) revenue;*
- (b) finance costs;*
- (c) share of the after-tax profit or loss of associates and joint ventures accounted for using the equity method;*
- (d) pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities attributable to discontinuing operations;*
- (e) tax expense;*
- (f) profit or loss;*
- (g) minority interest; and*
- (h) net profit or loss.*

Additional line items, headings and subtotals shall be presented on the face of the income statement when such presentation is relevant to an understanding of the entity's financial performance.

77. The effects of an entity's various activities, transactions and other events differ in frequency, risk and predictability, and the disclosure of the elements of financial performance assists in an understanding of the financial performance achieved and in making projections of future results. Additional line items are included on the face of the income statement, and the descriptions used and the ordering of items are amended when this is necessary to explain the elements of financial performance. Factors considered include materiality and the nature and function of the components of income and expenses. For example, a bank amends the descriptions to apply the more specific requirements in IAS 30. Income and expense items are offset when, and only when, the criteria in paragraph 29 are met.
- 78. *An entity shall not present any items of income and expense as extraordinary items, either on the face of the income statement or in the notes.***
79. No items of income and expense are presented as arising from outside the entity's ordinary activities.

Information to be Presented either on the Face of the Income Statement or in the Notes

- 80. *The nature and amount of items of income and expense that are of such size, nature or incidence that their disclosure is relevant to an understanding of the entity's financial performance shall be disclosed separately.***
81. The nature and amount of the items of income and expense described in paragraph 80 may be relevant to users of financial statements in understanding the financial position and financial performance of an entity and in making projections about financial position and financial performance.
82. Circumstances that may give rise to the separate disclosure of items of income and expense include:
- (a) the write-down of inventories to net realisable value or property, plant and equipment to recoverable amount, as well as the reversal of such write-downs;

- (b) a restructuring of the activities of an entity and the reversal of any provisions for the costs of restructuring;
 - (c) disposals of items of property, plant and equipment;
 - (d) disposals of long-term investments;
 - (e) discontinuing operations;
 - (f) litigation settlements; and
 - (g) other reversals of provisions.
- 83. *An entity shall present an analysis of expenses using a classification based on either the nature of expenses or their function within the entity.***
84. Entities are encouraged to present the analysis in paragraph 83 on the face of the income statement.
85. Expense items are subclassified to highlight components of financial performance that may differ in terms of frequency, potential for gain or loss and predictability. This analysis is provided in one of two forms.
86. The first form of analysis is referred to as the nature of expense method. Expenses are aggregated in the income statement according to their nature (for example, depreciation, purchases of materials, transport costs, wages and salaries, and advertising costs), and are not reallocated among various functions within the entity. This method is simple to apply in many smaller entities because no allocations of expenses between functional classifications are necessary.
87. The second form of analysis is referred to as the function of expense or cost of sales method and classifies expenses 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. This method often provides more relevant information to users than the classification of expenses by nature, but the allocation of costs to functions can be arbitrary and involves considerable judgement.

- 88. *Entities classifying expenses by function shall disclose additional information on the nature of expenses, including depreciation and amortisation expense and employee benefits expense.***
89. The choice between the function of expense method and the nature of expense method depends on historical and industry factors and the nature of the entity. Both methods provide an indication of those costs that might vary, directly or indirectly, with the level of sales or production of the entity. Because each method of presentation has merit for different types of entities, this Standard requires an entity to select the classification that presents the elements of the entity's financial performance most informatively. However, because information on the nature of expenses is useful in predicting future cash flows, additional disclosure is required when the function of expense classification is used. In paragraph 88, employee benefits means the same as in IAS 19, Employee Benefits.
- 90. *An entity shall disclose, either on the face of the income statement or the statement of changes in equity, or in the notes, the amount of dividends recognised during the period covered by the financial statements, and the related amount per share.***

Statement of Changes in Equity

- 91. *An entity shall present, as a separate component of its financial statements, a statement of changes in equity showing:***
- (a) *the profit or loss for the period;***
 - (b) *each item of income and expense that, as required by other Standards, is recognised directly in equity, and the total of these items; and***
 - (c) *the cumulative effect of changes in accounting policy and the correction of errors recognised under IAS 8.***

92. ***An entity shall also present, either within the statement of changes in equity or in the notes:***
- (a) ***the amounts of capital transactions with owners and distributions to owners;***
 - (b) ***the balance of accumulated profit or loss at the beginning of the period and at the balance sheet date, and the movements for the period; and***
 - (c) ***a reconciliation between the carrying amount of each class of equity capital, share premium and each reserve at the beginning and the end of the period, separately disclosing each movement.***
93. Changes in an entity's equity between two balance sheet dates reflect the increase or decrease in its net assets during the period. Except for changes resulting from transactions with owners acting in their capacity as owners, such as capital contributions and dividends, the overall change in equity represents the total amount of income and expenses, including gains and losses, generated by the entity's activities during the period.
94. This Standard requires all items of income and expense recognised in a period to be included in the determination of profit or loss unless another Standard requires or permits otherwise. Other Standards require some gains and losses, such as revaluation increases and decreases and particular foreign exchange differences, to be recognised directly as changes in equity. Because it is important to consider all items of income and expense in assessing changes in an entity's financial position between two balance sheet dates, this Standard requires the presentation of a statement of changes in equity that highlights an entity's total income and expenses, including those that are recognised directly in equity.
95. The requirements in paragraphs 91 and 92 may be met in a number of ways, for example, a columnar format that reconciles the opening and closing balances of each element within equity. An alternative is to present only the items set out in paragraph 91 in the statement of changes in equity. Under this approach, the items described in paragraph 92 are shown in the notes to the financial statements. Whichever approach is adopted, a subtotal is required of the items in paragraph 91(b) to enable users to derive the total income and expenses arising from the entity's activities during the period.

Cash Flow Statement

96. IAS 7, Cash Flow Statements, sets out requirements for the presentation of the cash flow statement and related disclosures. It states that cash flow information provides users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows.

Notes to the Financial Statements

Structure

97. *The notes to the financial statements of an entity shall:*
- (a) *present information about the basis of preparation of the financial statements and the specific accounting policies selected and applied for significant transactions and other significant events;*
 - (b) *disclose the information required by International Financial Reporting Standards and Interpretations of those Standards that is not presented elsewhere in the financial statements; and*
 - (c) *provide additional information that is not presented on the face of the financial statements but is relevant to an understanding of the balance sheet, income statement, statement of changes in equity and cash flow statement.*
98. *Notes to the financial statements shall be presented in a systematic manner. Each item on the face of the balance sheet, income statement, statement of changes in equity and cash flow statement shall be cross-referenced to any related information in the notes.*
99. Notes to the financial statements include narrative descriptions or disaggregations of amounts of items recognised in the financial statements and shown on the face of the balance sheet, income statement, statement of changes in equity and cash flow statement, as well as additional information about unrecognised items such as contingent liabilities and commitments. They include information required and encouraged to be disclosed by International Financial Reporting Standards and Interpretations of those Standards, and other disclosures

relevant to an understanding of the balance sheet, income statement, statement of changes in equity and cash flow statement.

100. Notes are normally presented in the following order, which assists users in understanding the financial statements and comparing them with those of other entities:

- (a) a statement of compliance with International Financial Reporting Standards and Interpretations of those Standards (see paragraph 11);
- (b) a summary of significant accounting policies applied, including the measurement basis or bases applied;
- (c) supporting information for items presented on the face of each financial statement in the order in which each financial statement and each line item is presented; and
- (d) other disclosures, including:
 - (i) contingencies, commitments and other financial disclosures; and
 - (ii) non-financial disclosures.

101. In some circumstances, it may be necessary or desirable to vary the ordering of specific items within the notes. For example, information on changes in fair value recognised in profit or loss may be combined with information on maturities of financial instruments, although the former disclosures relate to the income statement and the latter relate to the balance sheet. Nevertheless, a systematic structure for the notes is retained as far as practicable.

102. Notes providing information about the basis of preparation of the financial statements and specific accounting policies may be presented as a separate component of the financial statements.

Disclosure of Accounting Policies

103. An entity shall disclose in the summary of significant accounting policies:

- (a) the measurement basis (or bases) used in preparing the financial statements; and***
- (b) the other accounting policies used that are relevant to an understanding of the financial statements.***

104. In addition to other accounting policies used in the financial statements, it is important for users to be aware of the measurement basis or bases used (historical cost, current cost, net realisable value, fair value or recoverable amount) because they form the basis on which the financial statements are prepared. When more than one measurement basis is used in the financial statements, for example when particular classes of assets are revalued, it is sufficient to provide an indication of the categories of assets and liabilities to which each measurement basis is applied.

105. In deciding whether a particular accounting policy should be disclosed, management considers whether disclosure would assist users in understanding how transactions and other events are reflected in the reported financial performance and financial position. An entity considers presenting accounting policies related to at least the following:

- (a) revenue recognition;
- (b) consolidation principles;
- (c) application of the equity method of accounting for investments in associates;
- (d) business combinations;
- (e) joint ventures;
- (f) recognition and depreciation/amortisation of tangible and intangible assets;

- (g) capitalisation of borrowing costs and other expenditure;
- (h) construction contracts;
- (i) investment properties;
- (j) financial instruments and investments;
- (k) leases;
- (l) inventories;
- (m) taxes, including deferred taxes;
- (n) provisions;
- (o) employee benefit costs;
- (p) foreign currency translation;
- (q) definition of business and geographical segments and the basis for allocation of costs between segments;
- (r) definition of cash and cash equivalents; and
- (s) government grants.

Other Standards specifically require disclosure of accounting policies in many of these areas.

106. Each entity considers the nature of its operations and the policies that the users of its financial statements would expect to be disclosed for that type of entity. For example, an entity subject to income taxes would be expected to disclose its accounting policies for income taxes, including those applicable to deferred taxes and tax assets. When an entity has significant foreign operations or transactions in foreign currencies, disclosure of accounting policies for the recognition of foreign exchange gains and losses would be expected. When business combinations have occurred, the policies used for measuring goodwill and minority interest are disclosed.

107. An accounting policy may be significant even if amounts shown for current and prior periods are not material. It also is appropriate to disclose each significant accounting policy that is not specified by existing Standards and Interpretations of those Standards, but selected and applied in accordance with IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

108. An entity shall disclose, in the summary of significant accounting policies and/or other notes, the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements.

109. In applying accounting policies, management makes various judgements that can affect significantly the amounts of items recognised in the financial statements. For example, management makes judgements in determining whether financial assets are held-to-maturity investments. Under paragraph 108, an entity discloses those judgements made by management in applying accounting policies that have the most significant effect on the amounts of items recognised in the financial statements. These disclosures do not relate to the judgements disclosed under paragraph 110. Some of these disclosures are required by other Standards. For example, IAS 27, Consolidated and Separate Financial Statements, requires an entity to disclose the reasons why the entity's ownership interest does not constitute control, in respect of an investee that is not a subsidiary although more than half of its voting or potential voting power is owned directly or indirectly through subsidiaries.

Key Measurement Assumptions

110. An entity shall disclose in the notes information regarding key assumptions about the future, and other sources of measurement uncertainty, 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; and

(b) their carrying amount as at the balance sheet date.

111. The key assumptions and other sources of measurement uncertainty disclosed under paragraph 110 relate to the estimates that require management's most difficult, subjective or complex judgements. As the number of variables and assumptions affecting the possible future resolution of the uncertainties increases, those judgements become more subjective and complex, and the potential for a material adjustment to the carrying amounts of assets and liabilities normally increases accordingly.
112. The disclosures under paragraph 110 are presented in a manner that assists users of financial statements to understand the judgements management makes about the future. The nature and extent of the information provided vary according to the nature of the assumption and other circumstances. Examples of the types of disclosures made are:
- (a) the nature of the assumption or other measurement uncertainty;
 - (b) the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;
 - (c) the expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected; and
 - (d) an explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved.
113. Examples of key assumptions disclosed under paragraph 110 are future interest rates, future changes in salaries, future changes in prices affecting other costs, and useful lives.
114. When it is not possible, without undue cost or effort, to disclose the extent of the possible effects of the assumption or other measurement uncertainty, the entity discloses that it is reasonably possible, based on existing knowledge, that changes in conditions within the next financial year could require a material adjustment to the carrying amount of the asset or liability affected. In all cases, the entity discloses the nature and carrying amount of the asset or liability affected.

115. Some key assumptions referred to in paragraph 110 are disclosed under other Standards. For example, IAS 37, Provisions, Contingent Liabilities and Contingent Assets, requires disclosure, in certain circumstances, of major assumptions concerning future events affecting classes of provisions. In addition, IAS 32, Financial Instruments: Disclosure and Presentation requires disclosure of significant assumptions applied in estimating fair values of financial assets and financial liabilities that are carried at fair value.

Other Disclosures

116. An entity shall disclose in the notes:

- (a) the amount of dividends proposed or declared before the financial statements were authorised for issue but not recognised as a distribution to owners during the period, and the related amount per share; and*
- (b) the amount of any cumulative preference dividends not recognised.*

117. An entity shall disclose the following, if not disclosed elsewhere in information published with the financial statements:

- (a) the domicile and legal form of the entity;*
- (b) a description of the nature of the entity's operations and its principal activities; and*
- (c) the name of the parent and the ultimate parent of the group.*

Effective Date

118. This Standard becomes operative for annual financial statements covering periods beginning on or after 1 January 2003. Earlier adoption is encouraged. If earlier adoption affects the financial statements, an entity shall disclose that fact.

Appendix A

Basis for Conclusions (Revisions 200X)

- A1. This Basis for Conclusions summarises the Board's considerations in reaching the conclusions in this Exposure Draft. Individual Board members gave greater weight to some factors than to others.
- A2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 1. The Board's objectives in the Improvements project are to reduce or eliminate alternatives, redundancies and conflicts within existing Standards, to deal with some convergence issues and to make other improvements. As the intention of the Improvements project is not to reconsider the fundamental approach to the presentation of financial statements established by IAS 1, this Basis for Conclusions does not discuss requirements in IAS 1 that the Board has not reconsidered.

Departures from Standards and Interpretations

- A3. Paragraph 13 of IAS 1 permits an entity to depart from a requirement in a Standard in the extremely rare circumstances when management concludes that compliance with a requirement in a Standard would be misleading, and therefore that departure from a requirement is necessary to achieve a fair presentation. When such a departure occurs, paragraph 13 requires extensive disclosure of the facts and circumstances surrounding the departure and the treatment adopted.
- A4. The Board proposes to clarify in paragraph 10 that financial statements present fairly the financial position, financial performance and cash flows of an entity when they represent faithfully the effects of transactions and other events in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework for the Preparation and Presentation of Financial Statements.

- A5. The Board proposes to limit the circumstances in which an entity departs from a requirement in an International Financial Reporting Standard or an Interpretation of a Standard to the extremely rare circumstances in which management concludes that compliance with the requirement would be so misleading that it would conflict with the objective of financial statements set out in the Framework. Proposed guidance on this criterion states that an item of information would conflict with the objective of financial statements when it does not represent faithfully the transactions or other events that it either purports to represent or could reasonably be expected to represent and, consequently, it would be likely to affect adversely economic decisions made by users of financial statements.
- A6. The effect of these proposed amendments is to provide a framework within which an entity assesses how to present fairly the effects of transactions and other events, and within which an entity assesses whether complying with a requirement in an International Financial Reporting Standard or an Interpretation of a Standard is so misleading that it would not result in fair presentation.
- A7. When it developed these proposals, the Board discussed whether IAS 1 should be silent regarding departures from International Financial Reporting Standards or Interpretations of those Standards. The Board decided against that change, noting that such a change would remove its capability to specify the criteria under which departures from those Standards and Interpretations should occur.
- A8. When considering this issue, the Board also noted that requiring an entity to depart from a requirement in an International Financial Reporting Standard or an Interpretation of a Standard where considered necessary to achieve fair presentation would conflict with the regulatory framework in some jurisdictions. The Board proposes to amend IAS 1 to take into account the different regulatory frameworks concerning departures from accounting standards in the various jurisdictions in which entities prepare financial statements. Accordingly, the Exposure Draft proposes that when an entity's circumstances satisfy the criterion described in paragraph A5 for departure from a requirement in an International Financial Reporting Standard or an Interpretation of a Standard:

- (a) if the relevant regulatory framework requires or otherwise does not prohibit a departure from the requirement, the entity shall make that departure and the disclosures set out in proposed paragraph 14; and
- (b) if the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by making the disclosures set out in proposed paragraph 15.

This amendment would enable entities to comply with the requirements of IAS 1 when the relevant regulatory framework prohibits departures from accounting standards, while retaining the principle that entities should, to the maximum extent possible, ensure that financial statements provide a fair presentation.

A9. In some jurisdictions, the relevant regulatory framework is silent on whether an entity may depart from a requirement in an accounting standard in particular circumstances. The Board concluded that under the principle that entities should, to the maximum extent possible, ensure that financial statements provide a fair presentation, an entity should be required to depart from a requirement in an International Financial Reporting Standard or an Interpretation of a Standard whenever:

- (a) its circumstances satisfy the criterion for departure described in paragraph A5; and
- (b) the relevant regulatory framework does not prohibit such a departure.

A10. In view of the strict criteria proposed for departure from a requirement in an International Financial Reporting Standard or an Interpretation of a Standard, the Board proposes to include guidance that there is a rebuttable presumption that if other entities in similar circumstances comply with the requirement, the entity's compliance with the requirement would not be so misleading that it would conflict with the objective of financial statements set out in the Framework.

Extraordinary items

- A11. IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies, requires extraordinary items to be disclosed on the face of the income statement separately from the profit or loss from ordinary activities (paragraph 10). Paragraph 6 of IAS 8 defines extraordinary items as income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly .
- A12. The Board is proposing to eliminate the concept of extraordinary items from IAS 8 and to prohibit the presentation of items of income and expense as extraordinary items in the income statement and the notes. This prohibition would be set out in the revised IAS 1.
- A13. Some commentators on accounting standards have argued that extraordinary items should be presented in a separate component of the income statement because they are clearly distinct from all of the other items of income and expense, and because such presentation highlights to users of financial statements the items of income and expense to which the least attention should be given when predicting an entity's future performance.
- A14. The Board noted that items treated as extraordinary result from the normal business risks faced by an entity and decided they do not warrant presentation in a separate component of the income statement. The nature of a transaction or other event, rather than its frequency, should determine its presentation within the income statement. Items currently classified as extraordinary are only a subset of the items of income and expense that may warrant disclosure to assist users in predicting an entity's future performance.
- A15. Eliminating the category of extraordinary items should eliminate the need for arbitrary segregation of the effects of related external events some recurring and others not on the profit or loss of an entity for a period. For example, arbitrary allocations may be necessary to estimate the financial effect of an earthquake on an entity's profit or loss if it occurs during a major cyclical downturn in economic activity.

A16. The Board has in progress a project on Reporting Financial Performance, which addresses a number of issues concerning the presentation of information in the income statement. However, the Board decided to address extraordinary items as a part of its Improvements project. It is a discrete issue that provides an opportunity to enhance international convergence of accounting standards.

Minority interest

A17. As a consequence of eliminating the category of extraordinary items, the line item minority interest (that is, the portion of profit or loss attributable to minority interest) is the only difference between the line items profit or loss and net profit or loss required to be presented on the face of the income statement under proposed paragraph 76. Some Board members believe this presentation implies minority interest is an item of income or expense, and that IAS 1 should not require this presentation. Other Board members believe minority interest can be regarded as an attribution or apportionment of profit or loss that is not an item of income or expense.

A18. The Board has agreed to amend IAS 27, Consolidated Financial Statements and Accounting for Investments in Subsidiaries, to require that in consolidated balance sheets, minority interest is presented within equity because it does not meet the definition of a liability in the Framework. However, the Board has not considered the implications of this decision for the treatment of amounts attributable to minority interest elsewhere in the financial statements, such as their treatment in income statements. The Board will consider those implications later. Accordingly, the term minority interest has been retained as a line item required on the face of the income statement, and the position of that line item has been retained, for the purposes of this Exposure Draft.

Effect of events occurring after the balance sheet date on the classification of liabilities

A19. Paragraph 63 of IAS 1 includes:

An enterprise should continue to classify its long-term interest-bearing liabilities as non-current, even when they are due to be settled within twelve months of the balance sheet date if:

- (a) the original term was for a period of more than twelve months;
- (b) the enterprise intends to refinance the obligation on a long-term basis; and
- (c) that intention is supported by an agreement to refinance, or to reschedule payments, which is completed before the financial statements are authorised for issue.

A20. Paragraph 65 of IAS 1 states that:

Some borrowing agreements incorporate undertakings by the borrower (covenants) which have the effect that the liability becomes payable on demand if certain conditions related to the borrower's financial position are breached. In these circumstances, the liability is classified as non-current only when:

- (a) the lender has agreed, prior to the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach; and
- (b) it is not probable that further breaches will occur within twelve months of the balance sheet date.

A21. The Board considered the requirements in paragraphs 63 and 65 and concluded that refinancing, or the granting of a waiver of a right to demand payment, that occurs after the balance sheet date should not be taken into account in the classification of a liability.

A22. The Board decided to propose the following amendments:

- (a) to amend paragraph 63 to specify that a long-term financial liability due to be settled within twelve months of the balance sheet date should not be classified as a non-current liability because an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue. This amendment does not affect the classification of a liability as non-current when the entity has, under the terms of an existing loan facility, the discretion to refinance or roll over its obligations for at least twelve months after the balance sheet date (see proposed paragraph 60); and
- (b) to amend paragraph 65 to specify that a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach. However, if the lender has agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and:
 - (i) the entity rectifies the breach within the period of grace; or
 - (ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified (see proposed paragraphs 62-64).

A23. In developing these proposals, the Board noted an argument in favour of the requirements in paragraphs 63 and 65, namely that classifying a liability as current or non-current according to whether it is expected to use current working capital of the entity, rather than strictly on the basis of its date of maturity and whether it is callable at the balance sheet date, may provide more relevant information about the liability's future effect on the timing of the entity's resource flows.

A24. However, the Board noted the following arguments for changing paragraphs 63 and 65:

- (a) refinancing a liability after the balance sheet date does not affect the entity's liquidity and solvency *at the balance sheet date*, the reporting of which should reflect contractual arrangements in force on that date. Therefore, it is a non-adjusting event under IAS 10, Events After the Balance Sheet Date, and should not affect the presentation of the entity's balance sheet;
- (b) it is illogical to adopt a criterion that non-current classification of short-term obligations expected to be rolled over for at least twelve months after the balance sheet date depends on whether the roll-over is at the discretion of the entity (see proposed paragraph 61), and then to provide an exception based on refinancing occurring after the balance sheet date; and
- (c) in the circumstances set out in paragraph 65, unless the lender has waived its right to demand immediate repayment or granted a period of grace within which the entity may rectify the breach of the loan agreement, the financial condition of the entity at the balance sheet date was that the lender held an absolute right to demand repayment immediately, based on the terms of the loan agreement. The granting of a waiver changes the terms of the loan agreement, and therefore an entity's receipt of a waiver after the balance sheet date changes the nature of the liability to non-current when it occurs (without the prior grant of a period of grace to rectify the breach).

A25. The Board also noted that the non-adjusting events described above frequently would be disclosed in accordance with IAS 10 to enable users to consider these events.

Disclosure of judgements made by management in applying accounting policies

A26. The Board proposes to require disclosure of the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements. An example of these judgements is how management determines whether financial assets are held-to-maturity investments. The Board concluded that disclosure of the most important of these judgements would enable users of financial statements to understand better the accounting policies applied and to make comparisons between entities regarding the basis on which managements make these judgements.

Disclosure of key measurement assumptions

A27. The Board proposes to require disclosure of key assumptions about the future, and other sources of measurement uncertainty, 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 proposed disclosures include details of:

- (a) their nature; and
- (b) their carrying amount as at the balance sheet date.

A28. Determining the carrying amounts of various types of assets and liabilities requires the use of estimates of the effects of uncertain future events. For example, future-oriented estimates are necessary to measure the recoverable amount of classes of property, plant and equipment, the rate of technological obsolescence of inventories and specialised equipment, provisions subject to the effects of future litigation or legislation, and long-term employee benefit liabilities such as pension obligations. These estimates involve assumptions about such items as future interest rates, future changes in salaries and future changes in prices affecting other costs. No matter how diligently an entity estimates the carrying amounts of assets and liabilities subject to significant measurement uncertainty, the reporting of a point estimate in the balance sheet cannot capture all of the relevant information about the measurement of those assets and liabilities and the implications of those measures for the period's profit or loss.

- A29. The Framework states that The economic decisions that are taken by users of financial statements require an evaluation of the ability of an enterprise to generate cash and cash equivalents and of the timing and certainty of their generation. Effective disclosure of information about key assumptions and other sources of measurement uncertainty enhances the relevance, reliability and understandability of the information reported in financial statements.
- A30. The Board does not propose to prescribe the particular form or detail of the disclosures. Circumstances differ from entity to entity, and the nature of measurement uncertainty has many facets. The Board proposes to limit the scope of the disclosures to items that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities *within the next financial year*. The longer the future period to which the disclosures relate, the greater the range of items that would qualify for disclosure, and the less specific the disclosures that could be made about particular assets or liabilities. A longer period than the next financial year may obscure the most relevant information with other disclosures.

Appendix B

Alternative Views

- B1. Alternative views represent the views of Board members who voted against the publication of this Exposure Draft. Those Board members have concluded that the proposed revised text for IAS 1, Presentation of Financial Statements, taken as a whole, should not be published in its present form.
- B2. Board members' views (including the views of Board members who supported publication of this Exposure Draft) may change as a result of input received in the exposure process.
- B3. The IASB does not allow partial dissents. The Basis for Conclusions presents several views considered by the Board, including some supported by a minority of Board members who, nonetheless, support publication of the Exposure Draft for this Standard.

Net profit or loss

- B4. Two Board members disagree with the requirement of paragraph 76 of the Exposure Draft to display on the face of the income statement net profit or loss. The term is not defined and it is unclear what items represent the difference between profit or loss and net profit or loss.
- B5. These members believe the implication of this requirement, together with the requirement to also display the change in minority interest on the face of the income statement, is that minority interest represents an item of profit or loss. That conclusion would be inconsistent with the Framework for the Preparation and Presentation of Financial Statements and the Exposure Draft proposing amendments to IAS 27, Consolidated Financial Statements and Accounting for Investments in Subsidiaries.
- B6. These members note that the change in minority interest is another item needed to determine net profit or loss attributable to ordinary shareholders as described in paragraph 10 of IAS 33, Earnings Per Share. These members believe that, just as preference dividends and similar items are not displayed on the face of the income statement, the change in minority interest should not be displayed on that statement in determining an item called profit or loss or net profit or loss.

**Proposed Improvements to
International Accounting Standard IAS 8
(revised 1993)**

**Net Profit or Loss for the Period,
Fundamental Errors and Changes in
Accounting Policies**

International Accounting Standard IAS 8

(revised 200X)

~~Net Profit or Loss for the Period,~~ ~~Fundamental Errors and Changes in~~ **Accounting Policies, Changes in Accounting** **Estimates and Errors**

[Note: Although the text of this Exposure Draft is presented as a clean draft, the title above has been marked to show the proposed change.]

Invitation to Comment

The Board would particularly welcome answers to the questions set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Question 1

Do you agree that the allowed alternative treatment should be eliminated for voluntary changes in accounting policies and corrections of errors, meaning that those changes and corrections should be accounted for retrospectively as if the new accounting policy had always been in use or the error had never occurred (see paragraphs 20, 21, 32 and 33)?

Question 2

Do you agree with eliminating the distinction between fundamental errors and other material errors (see paragraphs 32 and 33)?

Summary of Main Changes

The main changes proposed are:

- to amend the scope of the Standard by:
 - including paragraphs 20-22 of IAS 1, Presentation of Financial Statements, which specify the criteria for the selection of accounting policies; and
 - removing the requirements in paragraphs 7-18 of IAS 8, which concern the presentation of items in the income statement. These requirements, including amendments, would be transferred to IAS 1.

Accordingly, the name of the Standard would change to Accounting Policies, Changes in Accounting Estimates and Errors .

- to remove the distinction between fundamental errors and other material errors, and add a definition of errors to proposed paragraph 3. The concept of a fundamental error is eliminated.
- to remove the allowed alternative treatment of corrections of errors set out in paragraphs 38-40 of IAS 8. Consequently, an entity no longer would be permitted to:
 - include the amount of the correction of an error in profit or loss for the current period; and
 - present comparative information as it was reported in the financial statements of prior periods.

Instead, the correction of an error would be accounted for retrospectively. This involves:

- either restating the comparative amounts for the prior period(s) in which the error occurred,

- or when the error occurred before the earliest prior period presented, restating the opening balance of retained earnings for that period

so that the financial statements are presented as if the error had never occurred (see proposed paragraphs 32 and 33).

- to amend paragraph 34 of IAS 8 so that when accounting retrospectively for a correction of an error, the basis for exemption from restating comparative information for a particular prior period changes from impracticability to undue cost or effort. This exemption would apply only to the particular prior period for which restating comparative information would cause undue cost or effort (see proposed paragraphs 32 and 33).
- to articulate the hierarchy of IASB pronouncements, and authoritative non-mandatory guidance, to consider when selecting accounting policies to apply in the preparation of financial statements. This would involve adding proposed paragraph 4 and amending paragraphs 20-22 of IAS 1 (which would be transferred to IAS 8).
- to add paragraph 7 to incorporate the Consensus in SIC-18, Consistency — Alternative Methods, namely that:
 - an entity shall select and apply its accounting policies for a period consistently for similar transactions, other events and circumstances, unless a Standard or an Interpretation of a Standard specifically requires or permits categorisation of items for which different policies may be appropriate; and
 - if a Standard or an Interpretation requires or permits categorisation of items, an appropriate accounting policy shall be selected and applied consistently to each category.

SIC-18 would be withdrawn.

- to amend paragraph 48 of IAS 8 to require, rather than encourage, disclosure of the nature of a future change in an accounting policy when an entity has yet to implement a new Standard that has been issued but not yet come into effect. In addition, disclosure would be required of the planned date of adoption, and an estimate of the effect of the change on the entity's financial position unless making such an estimate requires undue cost or effort (see proposed paragraph 19).
- to remove the allowed alternative treatment of voluntary changes in accounting policies set out in paragraphs 54-57 of IAS 8. Consequently, an entity no longer would be permitted to:
 - include the adjustment resulting from retrospective application of changes in accounting policies in profit or loss for the current period; and
 - present comparative information as it was reported in the financial statements of prior periods.

Instead, the adjustment resulting from retrospective application of changes in accounting policies would be made to the opening balance of retained earnings for the earliest prior period presented, and the other comparative amounts disclosed for each prior period presented, where applicable, as if the new accounting policy had always been in use (see proposed paragraph 20).

- to amend paragraph 49 of IAS 8 so that the basis for exemption from restating comparative information upon a voluntary change in an accounting policy changes from impracticability to undue cost or effort. This exemption would apply only to the particular prior period for which restating comparative information would require undue cost or effort (see proposed paragraph 21).

This Exposure Draft proposes extensive changes to IAS 8. Hence, for ease of reading, it is presented as a clean draft rather than a marked-up version that marks the changes.

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APPENDIX:

Basis for Conclusions (Revisions 200X)

International Accounting Standard IAS 8 (revised 200X)

Accounting Policies, Changes in Accounting Estimates and Errors

The standards, which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the Preface to International Accounting Standards. International Accounting Standards are not intended to apply to immaterial items (see paragraph 12 of the Preface).

Objective

The objective of this Standard is to prescribe the criteria for selecting accounting policies, and the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and errors, so that entities prepare and present their financial statements on a consistent basis. This enhances comparability with the entity's financial statements of previous periods and with the financial statements of other entities.

Scope

- 1. This Standard shall be applied in selecting accounting policies, and accounting for changes in accounting policies, changes in accounting estimates and errors.***
2. The tax effects of errors and changes in accounting policies are accounted for and disclosed in accordance with IAS 12, Income Taxes.

Definitions

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

Accounting policies are the specific principles, bases, conventions, rules and practices adopted by an entity in preparing and presenting financial statements.

Errors are omissions from, and other misstatements of, the entity's financial statements for one or more prior periods that are discovered in the current period and relate to reliable information that:

- (a) was available when those prior period financial statements were prepared; and*
- (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.*

Errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Retrospective application of a change in an accounting policy and of a correction of an error, respectively, are:

- (a) applying the new accounting policy to transactions, other events and circumstances as if that policy had always been in use; and*
- (b) recognising and disclosing the corrected amount(s) as if the error had never occurred.*

Prospective application of a change in an accounting policy and of recognising the effect of a change in an accounting estimate, respectively, are:

- (a) applying the new accounting policy to transactions, other events and circumstances occurring after the date as at which the policy is changed; and*

- (b) *recognising and disclosing the effect of the change in the accounting estimate in the periods affected by the change.*

Accounting Policies

Selection of Accounting Policies

4. *When an International Financial Reporting Standard or an Interpretation of a Standard applies to an item in the financial statements, the accounting policy or policies applied to that item shall be determined by considering the following in descending order:*
 - (a) *the Standard (including any Appendices that form a part of the Standard);*
 - (b) *the Interpretation;*
 - (c) *Appendices to the Standard that do not form a part of the Standard; and*
 - (d) *Implementation Guidance issued in respect of the Standard.*

5. *In the absence of a particular Standard or an Interpretation of a Standard that specifically applies to an item in the financial statements, management shall use its judgement in developing and applying an accounting policy that results in information that is:*
 - (a) *relevant to the decision-making needs of users; and*
 - (b) *reliable in that the financial statements:*
 - (i) *represent faithfully the results and financial position of the entity;*
 - (ii) *reflect the economic substance of transactions and other events, and not merely the legal form;*
 - (iii) *are neutral, ie free from bias;*

- (iv) are prudent; and*
 - (v) are complete in all material respects.*
6. *In making the judgement described in paragraph 5, management shall consider the following sources in descending order:*
- (a) the requirements and guidance in Standards, and Interpretations of Standards, dealing with similar and related issues, and Appendices and Implementation Guidance issued in respect of those Standards;*
 - (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses set out in the Framework for the Preparation and Presentation of Financial Statements; and*
 - (c) pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature, and accepted industry practices, to the extent, but only to the extent, that these are consistent with (a) and (b) of this paragraph.*

Consistency of Accounting Policies

7. *An entity shall select and apply its accounting policies for a period consistently for similar transactions, other events and circumstances, unless a Standard or an Interpretation of a Standard specifically requires or permits categorisation of items for which different policies may be appropriate. If a Standard or an Interpretation requires or permits categorisation of items, an appropriate accounting policy shall be selected and applied consistently to each category.*
8. Similar transactions, other events and circumstances are recognised, measured and presented in a consistent manner in an entity's financial statements.

Changes in Accounting Policies

9. *A change in an accounting policy shall be made only if it:*

- (a) is required by a Standard or an Interpretation of a Standard; or*
- (b) results in a more relevant and reliable presentation in the financial statements of the effects of transactions or other events on the entity's financial position, financial performance or cash flows.*

10. Users need to be able to compare the financial statements of an entity over a period of time to identify trends in its financial position, financial performance and cash flows. Therefore, the same accounting policies are adopted in each period unless a change in an accounting policy meets one of the criteria in paragraph 9.

11. *The following are not changes in accounting policies:*

- (a) the adoption of an accounting policy for transactions or other events that differ in substance from those previously occurring; and*
- (b) the adoption of a new accounting policy for transactions or other events that did not occur previously or were immaterial.*

The initial adoption of a policy to carry assets at revalued amounts under the allowed alternative treatment in IAS 16, Property, Plant and Equipment, or IAS 38, Intangible Assets, is a change in an accounting policy but is dealt with as a revaluation in accordance with IAS 16 or IAS 38, rather than in accordance with this Standard. Therefore, paragraphs 20-23 are not applicable to such changes in accounting policy.

Adoption of a Standard

12. *A change in an accounting policy that is made on the adoption of a Standard shall, subject to paragraph 13, be accounted for in accordance with the specific transitional provisions, if any, in that Standard.*
13. *When the specific transitional provisions in a Standard require the restatement of comparative information, the comparative information presented for a particular prior period need not be restated if restating the information would require undue cost or effort. When comparative information for a particular prior period is not restated, the new accounting policy shall be applied to the balances of assets and liabilities as at the beginning of the next period and, where applicable, a corresponding adjustment shall be made to the opening balance of retained earnings for the next period.*
14. *In the absence of any specific transitional provisions in a Standard, a change in an accounting policy shall be applied in accordance with paragraphs 20-23.*
15. *When applying the transitional provisions of a Standard has an effect on the current period or any prior period presented, an entity shall disclose the following:*
 - (a) *the fact that the change in an accounting policy is made in accordance with the transitional provisions of the Standard, with a description of those provisions;*
 - (b) *the amount of the adjustment for the current period and for each prior period presented;*
 - (c) *the amount of the adjustment relating to periods prior to those included in the comparative information; and*
 - (d) *the fact that comparative information has been restated, or that restatement for a particular prior period has not been made because it would require undue cost or effort.*

- 16. *When applying the transitional provisions of a Standard may have an effect in future periods, an entity shall disclose the fact that the change in an accounting policy is made in accordance with the transitional provisions of the Standard, with a description of those provisions affecting future periods.***
17. Enhancing the inter-period comparability of information assists users in making economic decisions, especially by allowing the assessment of trends in financial information for predictive purposes. There is a general presumption, therefore, that the benefits from restating comparative information exceed the resulting cost or effort and, accordingly, that an entity would make every reasonable effort to restate comparative amounts for each prior period presented.
18. In some circumstances, the cost or effort of restating comparative information for a particular prior period to achieve comparability with the current period would exceed the resulting benefits to be derived by users of financial statements. For example, data may not have been collected in the prior period(s) in a way that allows restatement, and recreating the information would require undue cost or effort. In such circumstances, an entity discloses the reason for not restating the comparative amounts.
- 19. *When an entity has not adopted a new Standard that has been issued but not yet come into effect, the entity shall disclose:***
- (a) *the nature of the future change or changes in accounting policy;***
 - (b) *the date by which adoption of the Standard is required;***
 - (c) *the date as at which it plans to adopt the Standard; and***
 - (d) *either:***
 - (i) *an estimate of the effect of the change(s) on its financial position; or***
 - (ii) *if such an estimate cannot be made without undue cost or effort, a statement to that effect.***

Voluntary Changes in Accounting Policies

- 20. A change in an accounting policy other than a change made under paragraph 12 shall be applied retrospectively. Subject to paragraph 21, the opening balance of retained earnings for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented shall be adjusted, where applicable, as if the new accounting policy had always been in use.*
- 21. Comparative information presented for a particular prior period need not be restated if restating the information would require undue cost or effort. When comparative information for a particular prior period is not restated, the new accounting policy shall be applied to the balances of assets and liabilities as at the beginning of the next period and a corresponding adjustment shall be made to the opening balance of retained earnings for the next period.*
22. When an accounting policy is changed, the amount of the resulting adjustment relating to periods prior to those presented in the financial statements is made against the opening balance of retained earnings of the earliest prior period presented. Any other information with respect to prior periods, such as historical summaries of financial data, also is restated. These restatements are not required for particular prior periods when they would require undue cost or effort.
- 23. When a change in an accounting policy has an effect on the current period or any prior period presented, or may have an effect in subsequent periods, an entity shall disclose the following:*
- (a) the reasons for the change;*
 - (b) the amount of the adjustment for the current period and for each prior period presented;*
 - (c) the amount of the adjustment relating to periods prior to those presented; and*
 - (d) that comparative information has been restated, or that restatement for a particular prior period has not been made because it would require undue cost or effort.*

Changes in Accounting Estimates

24. As a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgements based on the latest available, reliable information. Estimates may be required, for example, of bad debts; inventory obsolescence; the fair value of financial assets; or the useful lives of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.
25. An estimate may need revision if changes occur regarding the circumstances on which the estimate was based or as a result of new information, more experience or subsequent developments. By its nature, the revision of an estimate does not relate to prior periods and is not an error.
26. A change in an accounting estimate does not result from a change in the measurement basis or method applied, which is a change in an accounting policy. When it is difficult to distinguish between a change in an accounting policy and a change in an accounting estimate, the change is treated as a change in an accounting estimate, with appropriate disclosure.
27. ***The effect of a change in an accounting estimate shall be recognised 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.***
28. Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events, and circumstances from the date of the change in estimate. A change in an accounting estimate may affect the current period only, or both the current period and future periods. For example, a change in the estimate of the amount of bad debts affects only the current period and therefore is recognised in the current period. However, a change in the estimated

useful life of, or the expected pattern of consumption of the future economic benefits embodied in, a depreciable asset affects depreciation expense for the remainder of the current period and for each future period during the asset's remaining useful life. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods is recognised in future periods.

- 29. *The nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods shall be disclosed, subject to paragraph 30.***
- 30. *The amount of the effect on subsequent periods of a change in an accounting estimate need not be disclosed if estimating it would require undue cost or effort. If the amount of the effect in subsequent periods is not disclosed because estimating it requires undue cost or effort, that fact shall be disclosed.***

Errors

31. Corrections of errors are distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need revision as additional information becomes known. For example, the gain or loss recognised on the outcome of a contingency that previously could not be estimated reliably does not constitute the correction of an error.
- 32. *The amount of the correction of an error shall be accounted for retrospectively. Subject to paragraph 33, an error shall be corrected by:***
- (a) *either restating the comparative amounts for the prior period(s) in which the error occurred,***
 - (b) *or when the error occurred before the earliest prior period presented, restating the opening balance of retained earnings for that period***

so that the financial statements are presented as if the error had never occurred.

- 33. *Comparative information presented for a particular prior period need not be restated if restating the information would require undue cost or effort. When comparative information for a particular prior period is not restated, the opening balance of retained earnings for the next period shall be restated for the cumulative effect of the error before the beginning of that period.***
34. The correction of an error (which, by definition, relates to one or more prior periods) is excluded from the determination of profit or loss for the period in which the error is discovered. The financial statements are presented as if the error had never occurred, by correcting the error in the comparative information for the prior period(s) in which it occurred, unless an entity determines not to do so for a particular prior period because determining the amount of the correction would require undue cost or effort. The amount of the correction relating to errors that occurred in periods prior to those presented in comparative information in the financial statements is adjusted against the opening balance of retained earnings of the earliest prior period presented. Any other information presented with respect to prior periods, such as historical summaries of financial data, also is restated unless restatement would require undue cost or effort.

Disclosure of Errors

- 35. *An entity shall disclose the following:***
- (a) *the nature of the error;***
 - (b) *the amount of the correction for each prior period presented;***
 - (c) *the amount of the correction relating to periods prior to those presented in comparative information; and***
 - (d) *that comparative information has been restated, or that restatement for a particular prior period has not been made because it would require undue cost or effort.***

Effective Date

- 36. This Standard becomes operative for annual financial statements covering periods beginning on or after 1 January 2003. Earlier adoption is encouraged. If earlier adoption affects the financial statements, an entity shall disclose that fact.***

Appendix

Basis for Conclusions (Revisions 200X)

- A1. This Basis for Conclusions summarises the Board's considerations in reaching the conclusions in this Exposure Draft. Individual Board members gave greater weight to some factors than to others.
- A2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 8. The Board's objectives in the Improvements project are to reduce or eliminate alternatives, redundancies and conflicts within existing Standards, to deal with some convergence issues and to make other improvements. This Basis for Conclusions discusses the requirements of IAS 8 in respect of which fundamental changes are proposed, but not the other requirements of IAS 8.

Removing the allowed alternative treatments for changes in accounting policies and corrections of fundamental errors

- A3. IAS 8 includes allowed alternative treatments of voluntary changes in accounting policies (paragraphs 54-57) and corrections of fundamental errors (paragraphs 38-40). Under those allowed alternatives:
- (a) the adjustment resulting from retrospective application of a change in an accounting policy is included in profit or loss for the current period; and
 - (b) the amount of the correction of a fundamental error is included in profit or loss for the current period.
- A4. In both circumstances, comparative information is presented as it was reported in the financial statements of prior periods.

A5. The Board identified the removal of optional treatments for changes in accounting policies and corrections of errors as an important improvement to IAS 8. The Board is proposing to remove the allowed alternative treatments and require application of the benchmark treatments. Under the benchmark treatments for changes in accounting policies and corrections of errors, including the amendments proposed in paragraphs 20, 21, 32 and 33, these changes and corrections are accounted for retrospectively.

A6. Retrospective application of a change in an accounting policy involves:

- (a) adjusting the opening balance of retained earnings for the earliest prior period presented; and
- (b) restating other comparative information presented for each prior period;

where applicable, as if the new accounting policy had always been in use. However, comparative information need not be restated for a particular prior period if doing so would require undue cost or effort.

A7. Retrospective accounting for a correction of an error involves:

- (a) restating the comparative amounts for the prior period(s) in which the error occurred; or
- (b) when the error occurred before the earliest prior period presented, restating the opening balance of retained earnings for that period;

so that the financial statements are presented as if the error had never occurred.

A8. The Board concluded that the benchmark treatments are preferable to the allowed alternative treatments because, under the benchmark treatments:

- (a) profit or loss for the period of the change does not include effects of changes in accounting policies or errors relating to prior periods;

- (b) information presented in respect of prior periods is prepared on the same basis as the basis applied for the current period, and therefore is comparable. This information possesses a qualitative characteristic in the Framework for the Preparation and Presentation of Financial Statements, and provides the most useful information for trend analysis of income and expenses; and
 - (c) errors are not repeated in comparative information presented for prior periods.
- A9. Some argue that the allowed alternative treatments are preferable because:
- (a) correcting errors by restating prior period information involves an unjustifiable use of hindsight;
 - (b) recognising the effects of changes in accounting policies and corrections of errors in current period profit or loss makes them more prominent to users of financial statements; and
 - (c) each amount credited or debited to retained earnings as a result of an entity's activities has been reported as profit or loss in some period.
- A10. The Board concluded that restating prior period information to correct an error does not involve an unjustifiable use of hindsight because errors relate to reliable information that was available when the prior period financial statements were prepared and could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.
- A11. The Board concluded that the disclosures about changes in accounting policies and errors set out in proposed paragraphs 15, 23 and 35 should ensure their effects are sufficiently prominent to users of financial statements.
- A12. The Board also concluded that it is less important that each amount credited or debited to retained earnings as a result of an entity's activities be reported as profit or loss in some period than for the profit or loss for each period presented to represent faithfully the effects of transactions and other events occurring in that period.

Eliminating the distinction between fundamental errors and other material errors

A13. The Board also proposes to eliminate the distinction between fundamental errors and other material errors. Under this amendment, all material errors would be treated in the same manner as a fundamental error currently is treated under the benchmark treatment. The Board concluded that the definition of fundamental errors in IAS 8 is difficult to interpret consistently because the key feature of the definition that the error causes the financial statements of one or more prior periods no longer to be considered to have been reliable is also a feature of other material errors.

**Proposed Improvements to
International Accounting Standard IAS 17**
(revised 1997)

Leases

International Accounting Standard IAS 17

(revised 200X)

Leases

[Note: For the purpose of this Exposure Draft, the new text is underlined and the deleted text is struck through.]

Invitation to Comment

The Board would particularly welcome answers to the questions set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Question 1

Do you agree that when classifying a lease of land and buildings, the lease should be split into two elements a lease of land and a lease of buildings? The land element is generally classified as an operating lease under paragraph 11 of IAS 17, Leases, and the buildings element is classified as an operating or finance lease by applying the conditions in paragraphs 3-10 of IAS 17.

Question 2

Do you agree that when a lessor incurs initial direct costs in negotiating a lease, those costs should be capitalised and allocated over the lease term? Do you agree that only incremental costs that are directly attributable to the lease transaction should be capitalised in this way and that they should include those internal costs that are incremental and directly attributable?

Summary of Main Changes

This Exposure Draft proposes two limited amendments to IAS 17, Leases. The Board's research agenda includes a wider project on leases and, as a result, the Board decided not to consider changes to other aspects of IAS 17 in the Improvements project, including incorporating relevant SIC Interpretations into IAS 17.

The main changes proposed are:

- to clarify that when a lease of both land and buildings is classified, the lease shall be split into two elements a lease of land and a lease of buildings. The land element is generally classified as an operating lease under paragraph 11 of IAS 17. The buildings element is classified as an operating or finance lease by applying the conditions in paragraphs 3-10 of IAS 17.
- to eliminate the choice of how a lessor accounts for initial direct costs incurred in negotiating a lease by requiring that such costs that are incremental and directly attributable to the lease be capitalised and allocated over the lease term.

Contents

Limited revisions to International Accounting Standard IAS 17 (revised ~~1997~~ 200X)

Leases

[Marked-up text]

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Limited revisions to International Accounting Standard IAS 17 (revised ~~1997~~ 200X) Leases

Marked-up text

Scope

[Amend paragraph 1]

1. *However, this Standard ~~should~~ shall not be applied to the measurement by:
 - (a) *lessees of investment property ~~held under~~ accounted for as finance leases (see IAS 40, Investment Property);**

Definitions

[Amend paragraph 3]

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

Initial direct costs are incremental costs that are directly attributable to negotiating and arranging a lease, except for such costs incurred by manufacturer or dealer lessors.

Gross investment in the lease is the aggregate of:

- (a) *the minimum lease payments under a finance lease from the standpoint of the lessor, and*
- (b) *any unguaranteed residual value accruing to the lessor.*

Unearned finance income is the difference between:

- (a) the aggregate of the minimum lease payments under a finance lease from the standpoint of the lessor and any unguaranteed residual value accruing to the lessor, and***
- (b) the present value of (a) above, at the interest rate implicit in the lease.***

Net investment in the lease is the gross investment in the lease less unearned finance income.

The interest rate implicit in the lease is 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.

Classification of Leases

[Add new paragraphs 11A, 11B and 11C]

11. Leases of land and of land and buildings are classified as operating or finance leases in the same way as leases of other assets. However, a characteristic of land is that it normally has an indefinite economic life and, if title is not expected to pass to the lessee by the end of the lease term, the lessee does not receive substantially all of the risks and rewards incident to ownership. A payment made on entering into or acquiring such a leasehold represents pre-paid lease payments which are amortised over the lease term in accordance with the pattern of benefits provided.
- 11A. For a lease of both land and buildings, the land and buildings elements are considered separately for the purposes of lease classification, unless title to both elements is expected to pass to the lessee by the end of the lease term. When the land has an indefinite economic life, the land element is classified as an operating lease unless title is expected to pass to the lessee by the end of the lease term, in accordance with paragraph 11 of this Standard. The buildings element is classified as a finance or operating lease in accordance with paragraphs 3-10 of this Standard.**

- 11B. The minimum lease payments at the inception of a lease of land and buildings (including any up-front payments) are allocated between the land and the buildings elements in proportion to their relative fair values at the inception of the lease. If the lease payments cannot be allocated reliably between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases (for the buildings elements, this may be the case for example when none of the situations in paragraphs 8 and 9 above exists), in which case the entire lease is classified as an operating lease.
- 11C. For a lease of land and buildings in which the value of the land element at the inception of the lease is immaterial, the land and buildings may be treated as a single unit for the purpose of lease classification and classified as a finance or operating lease in accordance with paragraphs 3-10 of this Standard. In such a case, the economic life of the buildings is regarded as the economic life of the entire leased asset.

Leases in the Financial Statements of Lessors

Finance Leases

[Amend paragraphs 34 and 38, add new paragraph 29A, and delete paragraph 33]

28. *Lessors ~~should~~ shall recognise assets held under a finance lease in their balance sheets and present them as a receivable at an amount equal to the net investment in the lease.*
29. Under a finance lease substantially all the risks and rewards incident to legal ownership are transferred by the lessor, and thus the lease payment receivable is treated by the lessor as repayment of principal and finance income to reimburse and reward the lessor for its investment and services.
- 29A. Initial direct costs are often incurred by lessors in negotiating and arranging a lease. Such initial direct costs include amounts such as commissions, legal fees and internal costs that are incremental and directly attributable to negotiating and arranging the lease. For finance leases, these initial direct costs are included in the initial measurement of the finance lease receivable and reduce the amount of income recognised over the lease term.

33. ~~[Deleted] Initial direct costs, such as commissions and legal fees, are often incurred by lessors in negotiating and arranging a lease. For finance leases, these initial direct costs are incurred to produce finance income and are either recognised immediately in income or allocated against this income over the lease term. The latter may be achieved by recognising as an expense the cost as incurred and recognising as income in the same period a portion of the unearned finance income equal to the initial direct costs.~~
34. *Manufacturer or dealer lessors ~~should~~ shall recognise selling profit or loss in income for the period, in accordance with the policy followed by the ~~enterprise~~ entity for outright sales. If artificially low rates of interest are quoted, selling profit ~~should~~ shall be restricted to that which would apply if a commercial rate of interest were charged. ~~Initial direct costs~~ Costs incurred by manufacturer or dealer lessors in connection with negotiating and arranging a lease ~~should~~ shall be recognised as an expense in the income statement at the inception of the lease.*
38. Costs incurred by a manufacturer or dealer lessor in connection with negotiating and arranging a lease ~~Initial direct costs~~ are recognised as an expense at the commencement of the lease term because they are mainly related to earning the manufacturer s or dealer s selling profit.

Operating Leases

[Amend paragraph 44]

41. *Lessors ~~should~~ shall present assets subject to operating leases in their balance sheets according to the nature of the asset.*
42. *Lease income from operating leases ~~should~~ shall be recognised in income on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.³*

³ See also SIC - 15, Operating Leases — Incentives.

43. Costs, including depreciation, incurred in earning the lease income are recognised as an expense. Lease income (excluding receipts for services provided such as insurance and maintenance) is recognised in income on a straight line basis over the lease term even if the receipts are not on such a basis, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.
44. Initial direct costs incurred ~~specifically to earn revenues from an operating lease are either deferred and allocated to income over the lease term in proportion to the recognition of rent income, or are recognised as an expense in the income statement in the period in which they are incurred.~~ by lessors in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as the lease income. Initial direct costs include commissions, legal fees and those internal costs that are incremental and directly attributable to negotiating and arranging the lease.

Effective Date

[Amend paragraph 59, add new paragraph 59A]

59. ~~*This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1999. If an enterprise applies this Standard for financial statements covering periods beginning before 1 January 1999, the enterprise should disclose the fact that it has applied this Standard instead of IAS 17, Accounting for Leases, approved in 1982.*~~
- 59A. The amendments to paragraphs 3, 11-11C, 28-29A, 33, 34, 38 and 41-44 become operative for annual financial statements covering periods beginning on or after 1 January 2003. Earlier adoption is encouraged. If earlier adoption affects the financial statements, an entity shall disclose that fact.**

Appendix

Basis for Conclusions (Revisions 200X)

- A1. This Basis for Conclusions summarises the Board's considerations in reaching the conclusions in this Exposure Draft. Individual Board members gave greater weight to some factors than to others.
- A2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 17. The Board's objectives in the Improvements project are to reduce or eliminate alternatives, redundancies and conflicts within existing Standards, to deal with some convergence issues and to make other improvements. As the intention of the Improvements project is not to reconsider the fundamental approach to the accounting for leases established by IAS 17, this Basis for Conclusions does not discuss requirements in IAS 17 that the Board has not reconsidered.

Leases of land and buildings

- A3. Paragraph 11 of IAS 17 requires that a lease of land with an indefinite economic life is classified as an operating lease, unless title is expected to pass to the lessee by the end of the lease term. IAS 17 is not explicit about how to classify a lease of *land and buildings*. The Board decided to propose that such a lease be split into two elements a lease of land and a lease of buildings. The land element would generally be classified as an operating lease under paragraph 11 of IAS 17 and the buildings element classified as an operating or finance lease by applying the conditions in paragraphs 3-10 of IAS 17. The Board rejected the alternative approach of classifying a lease of land and buildings as an operating lease in its entirety.
- A4. The Board decided that the proposed approach better reflects the assets and liabilities that result from a lease of land and buildings, in particular in cases when the lease term is for the majority of the life of the buildings and the lease rentals are designed to pay out the lessor for the buildings. It also prevents the choice of accounting that would otherwise be available by adding a small amount of land to the lease contract. Lastly, it converges with requirements in Australia, Canada and the United States.

- A5. An issue that arises under this approach is how to treat leases for which it is not possible to measure the two elements reliably (eg because similar land and buildings are not sold or leased separately). One possibility would be to classify the entire lease as a finance lease. This would prevent a lessee asserting that it cannot separately measure the two elements in order to avoid finance lease treatment for the buildings. However, it could lead to leases being classified as finance leases when this is clearly not the case. In view of this, the Board decided to propose that when it is not possible to measure the two elements reliably, the entire lease is classified as a finance lease unless it is clear that both elements would be classified as an operating lease. For the buildings element, this may be the case for example when none of the situations in paragraphs 8 and 9 of IAS 17 (that indicate finance lease treatment) exists.
- A6. Finally, the Board discussed whether to allow or require an exception from the requirement to separate the land and buildings elements in cases when the value of the land element is small in relation to the value of the entire property. In such cases the benefits of separating the lease into two elements and accounting for each separately may not outweigh the costs. The Board noted that Australian, Canadian and US GAAP allow or require such leases to be classified and accounted for as a single unit, with finance lease treatment being used when the relevant criteria are met. The Board decided to allow the same approach when the land element is immaterial.

Lessors initial direct costs

- A7. Lessors may incur direct costs in negotiating a lease, such as commissions, brokers fees and legal fees. IAS 17 contains a choice on how to account for such costs — they may be either charged as an expense as incurred or allocated over the lease term.* In the case of a finance lease, paragraph 33 of IAS 17 states that allocation over the lease term *may* be achieved by recognising the cost as an expense and, in the same period, recognising an equal amount of unearned finance income.

* See IAS 17 paragraph 33 for finance leases and IAS 17 paragraph 44 for operating leases.

- A8. The Board decided that this latter treatment permitted by paragraph 33 of IAS 17 is not in accordance with the Framework for the Preparation and Presentation of Financial Statements. Its effect is to recognise some of the future finance income as income and an asset at the inception of the lease. However, at inception of the lease, the Framework's definitions of income and assets are not met. The Board therefore decided that if direct costs incurred by lessors are to be allocated over the lease term, this should be achieved by capitalising them.
- A9. The Board noted that standard-setters in Australia, Canada, France, Japan, the United Kingdom and the United States either permit or require initial direct costs to be allocated over the lease term. The Board also noted that other International Accounting Standards permit or require the capitalisation of a range of similar costs, generally subject to those costs being directly attributable to the acquisition of the asset in question. Hence, for reasons of convergence and comparability with other International Accounting Standards, the Board decided to propose that initial direct costs be capitalised and allocated over the lease term, and not recognised as an expense when incurred.
- A10. For consistency with other Standards, in particular IAS 39, Financial Instruments: Recognition and Measurement, the Board proposes that capitalisation is restricted to costs that are both incremental and directly attributable to negotiating and arranging a lease.
- A11. The Board also agreed to revisit the issue as part of the wider question of how to measure an asset on initial recognition, agenda priorities permitting.

**Proposed Improvements to
International Accounting Standard IAS 27**
(revised 2000)

**Consolidated Financial Statements and
Accounting for Investments in Subsidiaries**

International Accounting Standard IAS 27

(revised 200X)

Consolidated and Separate Financial Statements ~~and Accounting for~~ ~~Investments in Subsidiaries~~

[Note: For the purpose of this Exposure Draft, the new text is underlined and the deleted text is struck through.]

Invitation to Comment

The Board would particularly welcome answers to the questions set out below with reasons for those answers. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Question 1

Do you agree that a parent need not prepare consolidated financial statements if all the criteria in paragraph 8 are met?

Question 2

Do you agree that minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders equity (see paragraph 26)?

Question 3

Do you agree that investments in subsidiaries, jointly controlled entities and associates that are consolidated, proportionately consolidated or accounted for under the equity method in the consolidated financial statements should be either carried at cost or accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement, in the investor s separate financial statements (paragraph 29)?

Do you agree that if investments in subsidiaries, jointly controlled entities and associates are accounted for in accordance with IAS 39 in the consolidated financial statements, then such investments should be accounted for in the same way in the investor s separate financial statements (paragraph 30)?

Summary of Main Changes

The main changes proposed are:

- to modify the exemption from preparing consolidated financial statements (paragraph 8) to indicate that a parent need not present consolidated financial statements to comply with International Financial Reporting Standards if and only if:
 - (a) it is a wholly-owned subsidiary or the owners of the minority interests, including those not otherwise entitled to vote, unanimously agree that the parent need not present consolidated financial statements;
 - (b) its securities are not publicly traded;
 - (c) it is not in the process of issuing securities in public securities markets; and
 - (d) the immediate or ultimate parent publishes consolidated financial statements that comply with International Financial Reporting Standards.
- to incorporate the consensus in SIC-33, Consolidation and Equity Method — Potential Voting Rights and Allocation of Ownership Interests (paragraphs 12B and 15A), and to withdraw SIC-33.
- to change the criterion for exclusion from the scope of consolidation when control is intended to be temporary from in the near future to within twelve months (paragraph 13).
- to remove the exclusion from consolidation when a subsidiary operates under severe long-term restrictions that significantly impair its ability to transfer funds to the parent (paragraph 13) and indicate that severe long-term restrictions on the ability to transfer funds to the investor make it unlikely that control exists (paragraph 12A).
- to require use of uniform accounting policies for like transactions and other events in similar circumstances and not have a practicability exemption (paragraph 21).

- to require minority interests to be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity (paragraph 26).
- to require investments in subsidiaries, associates and jointly controlled entities that are consolidated, proportionately consolidated or accounted for under the equity method in the consolidated financial statements to be either carried at cost or accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement, in the investor's separate financial statements (paragraph 29).
- to require investments in subsidiaries, associates and jointly controlled entities that are accounted for in accordance with IAS 39 in the consolidated financial statements to be accounted for in the same way in the investor's separate financial statements (paragraph 30).
- to require additional disclosures (paragraphs 32 and 33).

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International Accounting Standard IAS 27 (revised 2000 200X) Consolidated and Separate Financial Statements and Accounting for Investments in Subsidiaries

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APPENDIX: Basis for Conclusions (Revisions 200X)		

International Accounting Standard IAS 27 (revised ~~2000~~ 200X)

Consolidated and Separate Financial Statements and ~~Accounting for Investments in Subsidiaries~~

The standards, which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the Preface to International Accounting Standards. International Accounting Standards are not intended to apply to immaterial items (see paragraph 12 of the Preface).

Scope

1. *This Standard ~~shall~~ **should** be applied in the preparation and presentation of consolidated financial statements for a group of entities enterprises under the control of a parent.*
2. ~~5.~~ This Standard does not deal with:
 - (a) methods of accounting for business combinations and their effects on consolidation, including goodwill arising on a business combination (see IAS 22 (revised 1998), Business Combinations).
3. ~~2.~~ *This Standard ~~shall~~ **should** also be applied in accounting for investments in subsidiaries, jointly controlled entities and associates in the ~~a parent's~~ separate financial statements of a parent, venturer or investor.*
4. Separate financial statements are financial statements prepared in addition to consolidated financial statements prepared in accordance with the requirements of this Standard, or in addition to financial statements prepared in accordance with the requirements in IAS 31, Financial Reporting of Interests in Joint Ventures, or in IAS 28, Investments in Associates. Separate financial statements are also those financial statements described in paragraphs 8 and 9.

3. ~~[Deleted] This Standard supersedes IAS 3, Consolidated Financial Statements, except insofar as that Standard deals with accounting for investments in associates (see IAS 28, Accounting for Investment in Associates).~~
4. ~~[Deleted] Consolidated financial statements are encompassed by the term financial statements included in the Preface to International Accounting Standards. Therefore, consolidated financial statements are prepared in accordance with International Accounting Standards.~~
5. ~~[Deleted] This Standard does not deal with:~~
 - (a) ~~methods of accounting for business combinations and their effects on consolidation, including goodwill arising on a business combination (see IAS 22 (revised 1998), Business Combinations);~~
 - (b) ~~accounting for investments in associates (see IAS 28, Accounting for Investments in Associates); and~~
 - (c) ~~accounting for investments in joint ventures (see IAS 31, Financial Reporting of Interests in Joint Ventures).~~

Definitions

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

Control ~~(for the purpose of this Standard)~~ *is the power to govern the financial and operating policies of an entity enterprise so as to obtain benefits from its activities.*

A subsidiary *is an entity enterprise, including an unincorporated entity such as a partnership, that is controlled by another entity enterprise (known as the parent).*

A parent *is an entity enterprise that has one or more subsidiaries.*

A group *is a parent and all its subsidiaries.*

Consolidated financial statements are the financial statements of a group presented as those of a single economic entity enterprise.

Minority interest is that portion part of the profit or loss net results of operations and of net assets of a subsidiary attributable to equity interests that which are not owned, directly or indirectly through subsidiaries, by the parent.

The cost method is a method of accounting whereby the investment is recognised at cost. The investor recognises income from the investment only to the extent that the investor receives distributions from accumulated net profits of the investee arising after the date of acquisition.

Presentation of Consolidated Financial Statements

7. A parent, other than a parent described mentioned in paragraph 8, shall should present consolidated financial statements.
8. A parent need not present consolidated financial statements to comply with International Financial Reporting Standards if and only if:
 - (a) it is a wholly-owned subsidiary or the owners of the minority interests, including those not otherwise entitled to vote, unanimously agree that the parent need not present consolidated financial statements;
 - (b) its securities are not publicly traded;
 - (c) it is not in the process of issuing securities in public securities markets; and
 - (d) the immediate or ultimate parent publishes consolidated financial statements that comply with International Financial Reporting Standards.

Such a parent shall prepare financial statements in accordance with the requirements in paragraphs 29, 30, and 33 of this Standard for separate financial statements.

~~A parent that is a wholly owned subsidiary, or is virtually wholly owned, need not present consolidated financial statements provided, in the case of one that is virtually wholly owned, the parent obtains the approval of the owners of the minority interest. Such a parent should disclose the reasons why consolidated financial statements have not been presented together with the bases on which subsidiaries are accounted for in its separate financial statements. The name and registered office of its parent that publishes consolidated financial statements should also be disclosed.~~

9. The financial statements of such a parent as is described in paragraph 8, and prepared in accordance with paragraphs 29, 30 and 33, are the only financial statements prepared for the entity. Users of the financial statements of a parent are usually concerned with, and need to be informed about, the financial position, results of operations and changes in financial position of the group as a whole. This need is served by consolidated financial statements, which present financial information about the group as that of a single enterprise without regard for the legal boundaries of the separate legal entities.
10. ~~[Deleted]~~ A parent that is itself wholly owned by another enterprise may not always present consolidated financial statements since such statements may not be required by its parent and the needs of other users may be best served by the consolidated financial statements of its parent. In some countries, a parent is also exempted from presenting consolidated financial statements if it is virtually wholly owned by another enterprise and the parent obtains the approval of the owners of the minority interest. Virtually wholly owned is often taken to mean that the parent owns 90% or more of the voting power.

Scope of Consolidated Financial Statements

11. ~~A parent which issues e~~**Consolidated financial statements shall** ~~should consolidate a parent and all of its subsidiaries, foreign and domestic, other than those referred to in paragraph 13.~~

12. The consolidated financial statements include all entities ~~enterprises~~ that are controlled by the parent, other than those subsidiaries excluded in accordance with ~~for reasons in~~ paragraph 13. Control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than ~~one~~ half of the voting power of an entity ~~enterprise~~ unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control. Control also exists ~~even~~ when the parent owns ~~one~~ half or less of the voting power of an entity ~~enterprise~~ when there is:¹
- (a) power over more than ~~one~~ 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 ~~enterprise~~ 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.

12A. Control may be precluded when an investee is in legal reorganisation or in bankruptcy or operates under severe long-term restrictions on its ability to transfer funds to the investor.

12B. An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity voting power or reduce another party's voting power over the financial and operating policies of another entity (potential voting rights). The existence and effect of potential voting rights that are presently exercisable or presently convertible, including potential voting rights held by another entity, are considered when assessing whether an entity has the power to govern the financial and operating policies of another entity.

¹ See also SIC - 12, Consolidation — Special Purpose Entities.

13. A subsidiary ~~shall~~ ~~should~~ be excluded from consolidation when:

- (a) ~~control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal within twelve months from acquisition, in the near future;~~
~~or~~
- (b) ~~it operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent.~~

Investments in sSuch subsidiaries shall should be accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement, at fair value with changes in fair value included in profit or loss of the period of the change.

13A. A subsidiary is not excluded from consolidation simply because the investor is a venture capital organisation, mutual fund, unit trust or similar entity.

14. A subsidiary is not excluded from consolidation because its business activities are dissimilar from those of the other entities ~~enterprises~~ within the group. ~~Better~~ Relevant information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries. For example, the disclosures required by IAS 14, Segment Reporting, help to explain the significance of different business activities within the group.

Consolidation Procedures

15. In preparing consolidated financial statements, the financial statements of the parent and its subsidiaries are combined on a line-by-line basis by adding together like items of assets, liabilities, equity, income and expenses. In order that the consolidated financial statements present financial information about the group as that of a single economic entity ~~enterprise~~, the following steps are then taken:

- (a) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary are eliminated (see IAS 22 (revised 1998), Business Combinations, which ~~also~~ describes the treatment of any resultant goodwill);
- (b) minority interests in the net profit or loss ~~income~~ of consolidated subsidiaries for the reporting period are identified and adjusted against the income of the group ~~in order~~ to arrive at the net income attributable to the owners of the parent; and
- (c) minority interests in the net assets of consolidated subsidiaries are identified and presented in the consolidated balance sheet within equity, separately from ~~liabilities and~~ the parent shareholders' equity. Minority interests in the net assets consist of:
 - (i) the amount at the date of the original combination calculated in accordance with IAS 22 (revised 1998), Business Combinations; and
 - (ii) the minority's share of changes ~~movements~~ in equity since the date of the combination.

15A. When potential voting rights exist, the proportions of profit or loss and changes in equity allocated to the parent and minority interests are determined based on present ownership interests and do not reflect the possible exercise or conversion of potential voting rights. As a result, instruments containing potential voting rights are accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement.

16. ~~[Deleted] Taxes payable by either the parent or its subsidiaries on distribution to the parent of the profits retained in subsidiaries are accounted for in accordance with IAS 12, Income Taxes.~~

17. ~~Intragroup balances, and intragroup transactions, and resulting unrealised profits and losses shall should be eliminated in full. Unrealised losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.~~

18. Intragroup balances and intragroup transactions, including revenue sales, expenses and dividends, are eliminated in full. Unrealised p~~rofits and losses~~ resulting from intragroup transactions that are recognised included in the ~~carrying amount of~~ assets, such as inventory and fixed assets, are eliminated in full. Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements. Unrealised losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered. IAS 12, Income Taxes, applies to Timing temporary differences that arise from the elimination of unrealised profits and losses resulting from intragroup transactions are dealt with in accordance with IAS 12, Income Taxes.
19. ***When the financial statements of a subsidiary used in the preparation of consolidated~~ion~~ financial statements are prepared as of drawn up to a different reporting dates from that of the parent, adjustments shall should be made for the effects of significant transactions or other events that occur between that~~ose~~ dates and the date of the parent s financial statements. In any case, the difference between the reporting dates of the subsidiary and the parent shall should be no more than three months. The length of the reporting periods and any difference in the reporting dates shall be the same from period to period.***
20. The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements are usually prepared as of drawn up to the same date. When the reporting dates of the parent and a subsidiary are different, the subsidiary often prepares, for consolidation purposes, financial statements as of at the same date as the financial statements of the parent group. When financial statements as of the same date as the parent cannot be prepared without undue cost or effort it is impracticable to do this, financial statements of the subsidiary as of drawn up to a different reporting dates may be used, provided the difference is no greater than three months and adjustments are made for the effects of any significant transactions or events that occur between the different reporting dates. The consistency principle dictates that the length of the reporting periods and any difference in the reporting dates should be the same from period to period.

21. *Consolidated financial statements shall should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.*
22. ~~In many cases,~~ 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 ~~when they are used in preparing the consolidated financial statements.~~
23. The income and expenses results of operations of a subsidiary are included in the consolidated financial statements ~~as~~ from the date of acquisition; as defined in ~~which is the date on which control of the acquired subsidiary is effectively transferred to the buyer, in accordance with IAS 22 (revised 1998), Business Combinations.~~ The income and expenses results of operations of a subsidiary disposed of are included in the consolidated financial statements ~~income statement~~ until the date of disposal, which is the date on which the parent ceases to ~~have~~ control of the subsidiary. The difference between the proceeds from the disposal of the subsidiary and ~~the~~ its carrying amount as of the date of disposal, including the cumulative amount of any exchange differences that relate to the subsidiary recognised in equity in accordance with IAS 21, The Effects of Changes in Foreign Exchange Rates, ~~of its assets less liabilities as of the date of disposal~~ is recognised in the consolidated income statement as the gain ~~profit~~ or loss on the disposal of the subsidiary. ~~In order to ensure the comparability of the financial statements from one accounting period to the next, supplementary information is often provided about the effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date and the results for the reporting period and on the corresponding amounts for the preceding period.~~

24. *An investment in an entity ~~enterprise~~ shall ~~should~~ be accounted for in accordance with IAS 39, *Financial Instruments: Recognition and Measurement*, from the date that it ceases to be ~~fall within the definition of a subsidiary~~, and provided that it does not become an associate as defined in IAS 28, Accounting for Investments in Associates, or a jointly controlled entity as defined in IAS 31, Financial Reporting of Interests in Joint Ventures.*
25. *The carrying amount of the investment at the date that it ceases to be a subsidiary shall ~~be~~ ~~is~~ regarded as cost on initial measurement as a financial asset under IAS 39, Financial Instruments: Recognition and Measurement thereafter.*
26. *Minority interests shall ~~should~~ be presented in the consolidated balance sheet within equity, separately from ~~liabilities and the parent shareholders equity~~. Minority interests in the profit or loss ~~income of the group~~ shall ~~should~~ also be separately presented.*
27. ~~The~~ Losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the subsidiary's equity ~~of the subsidiary~~. The excess, and any further losses applicable to the minority, are charged against the majority interest except to the extent that the minority has a binding obligation ~~to~~, and is able to, make an additional investment to cover ~~make good~~ the losses. If the subsidiary subsequently reports profits, such profits are ~~the majority interest is allocated to the majority interest~~ all such profits until the minority's share of losses previously absorbed by the majority has been recovered.
28. If a subsidiary has outstanding cumulative preferred shares ~~that~~ ~~which~~ are held by minority interests ~~outside the group~~ and classified as equity, the parent computes its share of profits or losses after adjusting for the ~~subsidiary's preferred dividends~~ on such shares, whether or not dividends have been declared.

Accounting for Investments in ~~Subsidiaries~~ in a Parent's ~~an Investor's~~ Separate Financial Statements

29. ~~In a parent's separate financial statements, When separate financial statements are prepared, investments in subsidiaries, jointly controlled entities and associates that are consolidated, proportionately consolidated or accounted for under the equity method included in the consolidated financial statements prepared in accordance with the requirements of this Standard or in financial statements prepared in accordance with the requirements of IAS 31, Financial Reporting of Interests in Joint Ventures, or IAS 28, Investments in Associates, should shall be accounted for either:~~

(a) ~~carried at cost, or~~

(b) ~~accounted for using the equity method as described in IAS 28, Accounting for Investments in Associates; or~~

(c) ~~accounted for as available-for-sale financial assets as described in accordance with IAS 39, Financial Instruments: Recognition and Measurement,~~

in the investor's separate financial statements as described in paragraph 4 of this Standard. The same method shall be applied for each category of investments.

29A. This Standard does not mandate which entities publish separate financial statements. Paragraphs 29, 30 and 33 apply when an entity prepares separate financial statements that purport to comply with International Financial Reporting Standards.

Cost Method

29B. Under the cost method, an investor recognises its investment in the investee at cost. The investor recognises income only to the extent that it receives distributions from the accumulated net profits of the investee arising after the date of acquisition by the investor. Distributions received in excess of such profits are regarded as a recovery of investment and are recognised as a reduction of the cost of the investment.

30. *Investments in subsidiaries, jointly controlled entities and associates that are ~~excluded from~~ accounted for in accordance with IAS 39 in the consolidated financial statements ~~shall~~ ~~should~~ be accounted for in the same way in the investor's separate financial statements and in the financial statements of a parent that need not present consolidated financial statements. ~~either:~~*

(a) carried at cost;

(b) accounted for using the equity method as described in IAS 28, Accounting for Investments in Associates; or

(c) accounted for as available-for-sale financial assets as described in IAS 39, Financial Instruments: Recognition and Measurement.

30A. Users of the financial statements of a parent, joint venturer or investor in an associate are usually concerned with, and need to be informed about, the financial position, results of operations and changes in financial position of the group as a whole. This need is served by consolidated financial statements or financial statements in which the associate is accounted for under the equity method, that present financial information about the group as a single economic entity without regard for the legal boundaries of the separate legal entities. In contrast, separate financial statements present financial information about the entity's position viewed as an investor.

31. ~~[Deleted] In many countries separate financial statements are presented by a parent in order to meet legal or other requirements.~~

Disclosure

32. ~~In addition to those disclosures required by paragraphs 8 and 21, the following disclosures shall be made in consolidated financial statements:~~

- ~~(a) in consolidated financial statements a listing of significant subsidiaries including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held;~~
- ~~(b) in consolidated financial statements, where applicable:~~
 - ~~(a) the fact that a subsidiary is not consolidated, in accordance with paragraph 13 of this Standard, because control is temporary the reasons for not consolidating a subsidiary;~~
 - ~~(b) summarised financial information of subsidiaries that are not consolidated, either individually or in groups, including the amounts of total assets, total liabilities, revenues and profit or loss;~~
 - ~~(c) the nature of the relationship between the parent and a subsidiary of which the parent does not own, directly or indirectly through subsidiaries, more than one half of the voting power;~~
 - ~~(d) the name of for an investee enterprise in of which more than one half of the voting or potential voting power is owned, directly or indirectly through subsidiaries, but which, because of the absence of control, is not a subsidiary, the reasons why the ownership does not constitute control; and~~
 - ~~(iv) the effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date, the results for the reporting period and on the corresponding amounts for the preceding period; and~~

- (e) the reporting date of the financial statements of a subsidiary when such financial statements are used to prepare consolidated financial statements and are as of a reporting date or for a period that is different from that of the parent, and the reason for using a different reporting date or different period; and
- (f) the nature and extent of any restrictions on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends, repayment of loans or advances (ie borrowing arrangements, regulatory restraints etc).
- ~~(e) in the parent's separate financial statements, a description of the method used to account for subsidiaries.~~
33. The following disclosures shall be made in the investor's separate financial statements and in the financial statements of a parent that need not present consolidated financial statements:
- (a) the reasons why separate financial statements are prepared;
- (b) the name of the immediate or ultimate parent and a reference to the consolidated financial statements and or the financial statements in which associates and jointly controlled entities are accounted for under the equity method or proportionate consolidation method in accordance with IAS 28, Accounting for Investments in Associates, and IAS 31, Financial Reporting of Interests in Joint Ventures; and
- (c) a description of the method used to account for investments in subsidiaries, associates and jointly controlled entities.

Effective Date

- ~~334. This Standard becomes operative for annual financial statements covering periods beginning on or after 1 January 2003. Earlier adoption is encouraged. If earlier adoption affects the financial statements, an entity shall disclose that fact. This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1990.~~

Appendix

Basis for Conclusions (Revisions 200X)

- A1. This Basis for Conclusions summarises the Board's considerations in reaching the conclusions in this Exposure Draft. Individual Board members gave greater weight to some factors than to others.
- A2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 27. The Board's objectives in the Improvements project are to reduce or eliminate alternatives, redundancies and conflicts within existing Standards, to deal with some convergence issues and to make other improvements. As the intention of the Improvements project is not to reconsider the fundamental approach to consolidation established in IAS 27, this Basis for Conclusions does not discuss requirements in IAS 27 that the Board has not reconsidered.

Exemption from preparing consolidated financial statements

- A3. Paragraph 8 of IAS 27 (revised 2000) permits wholly-owned and virtually wholly-owned subsidiaries to be excluded from the requirements of preparing consolidated financial statements. The Board considered whether to withdraw this exemption.
- A4. The Board decided to retain the exemption, so that companies in a group that are required by law to publish financial statements under IASs in addition to the group's consolidated financial statements would not be unduly burdened.
- A5. The Board noted that in some circumstances users can find sufficient information for their purposes regarding a subsidiary from either its separate financial statements or the group's consolidated financial statements. In addition, the users of financial statements of a subsidiary often have, or can get access to, more information.

- A6. Having agreed to retain the exemption, the Board decided to propose modifying the exemption as described in paragraph 8 of this Exposure Draft. Among other things, the Board proposes to extend the exemption to a parent that is not wholly owned if the owners of the minority interest, including those not otherwise entitled to vote, unanimously agree. The Board noted that there is no reason why the exemption should not be extended when all the owners are content not to have consolidated financial statements.

Minority interests

- A7. Minority interest is defined in IAS 27 and IAS 22 (revised 1998), Business Combinations, as that part of the net results of operations and of net assets of a subsidiary attributable to interests, which are not owned, directly or indirectly through subsidiaries, by the parent. Paragraph 26 of IAS 27 requires that minority interests be presented in the consolidated balance sheet separately from liabilities and the parent shareholders equity. The Board considered whether to amend this requirement.
- A8. The Board decided to propose a modification that minority interests be presented in the consolidated balance sheet within equity, separately from the parent shareholders equity. The Board noted that a minority interest is not a liability of a group because it does not meet the definition of a liability in the Framework for the Preparation and Presentation of Financial Statements.
- A9. Paragraph 49(b) of the Framework states that 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. Paragraph 60 of the Framework further indicates that an essential characteristic of a liability is that the entity has a present obligation and that an obligation is a duty or responsibility to act or perform in a particular way. The Board noted that the existence of a minority interest in the net assets of a subsidiary does not give rise to a present obligation of the group, the settlement of which is expected to result in an outflow of economic benefits from the group.

- A10. Rather, the Board noted that a minority interest represents the residual interest in the net assets of those subsidiaries held by some of the shareholders of the subsidiaries within the group, and therefore meets the Framework's definition of equity. Paragraph 49(c) of the Framework states that equity is the residual interest in the assets of the entity after deducting all its liabilities.
- A11. The Board noted that although there could potentially be a number of consequences to the classification of minority interests, it does not propose any change in the recognition and measurement of minority interests at present. Issues on the recognition and measurement of minority interests are being addressed as part of the Business Combinations project (phase II).

Measurement of investments in subsidiaries, associates and jointly controlled entities in the investor's separate financial statements

- A12. Paragraph 29 of IAS 27 permits three alternatives on the measurement in a parent's separate financial statements of investments in subsidiaries included in consolidated financial statements: cost, the equity method, or as available-for-sale financial assets under IAS 39 (revised 2000), Financial Instruments: Recognition and Measurement. Paragraph 12 of IAS 28 (revised 2000), Accounting for Investments in Associates, permits the same alternatives for investments in associates in separate financial statements, and paragraph 38 of IAS 31 (revised 2000) indicates that IAS 31 does not indicate a preference for any particular treatment for accounting for interests in jointly controlled entities in a venturer's separate financial statements. The Board decided to require use of cost or IAS 39 in the investor's separate financial statements prepared in addition to the financial statements presenting the group as a single economic entity.

- A13. Although the equity method would provide users with profit and loss information similar to that obtained from consolidation, the Board noted that such information is reflected in the investor's economic entity financial statements and is not relevant to users of its separate financial statements prepared in addition to those economic entity financial statements. On the other hand, separate financial statements prepared using either the fair value method required by IAS 39 or the cost method would be relevant. Using the fair value method required by IAS 39 would provide an indication of current value. Using the cost method also results in relevant information, depending on the purpose of preparing the separate financial statements. For example, lenders to the parent might be more interested in seeing the dividend income from subsidiaries as would be presented under the cost method.
- A14. Regarding subsidiaries that are not consolidated under paragraph 13 of IAS 27, paragraph 30 of IAS 27 permits the same alternatives as are permitted for those included in consolidation cost, the equity method, or as available-for-sale financial assets under IAS 39. The Board considered whether to eliminate one or more of these choices and decided to propose requiring use of IAS 39, which achieves consistency with the treatment of these subsidiaries in consolidated financial statements. The Board noted that there is no reason to require any method that is not used in the consolidated financial statements.

**Proposed Improvements to
International Accounting Standard IAS 28**
(revised 2000)

Accounting for Investments in Associates

International Accounting Standard IAS 28

(revised 200X)

Accounting for Investments in Associates

[Note: For the purpose of this Exposure Draft, the new text is underlined and the deleted text is struck through.]

Invitation to Comment

The Board would particularly welcome answers to the questions set out below with reasons for those answers. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Question 1

Do you agree that IAS 28 and IAS 31, Financial Reporting of Interests in Joint Ventures, should not apply to investments that otherwise would be associates or joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities if these investments are measured at fair value in accordance with IAS 39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in those industries (see paragraph 1)?

Question 2

Do you agree that the amount to be reduced to nil when an associate incurs losses should include not only investments in the equity of the associate but also other interests such as long-term receivables (paragraph 22)?

Summary of Main Changes

The main changes proposed are:

- to exclude from the scope of IAS 28 and IAS 31, Financial Reporting of Interests in Joint Ventures, investments that would otherwise be associates or joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities that are measured at fair value in accordance with IAS 39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in those industries (paragraph 1).
- to incorporate the consensus in SIC-33, Consolidation and Equity Method — Potential Voting Rights and Allocation of Ownership Interests (paragraph 5A) and to withdraw SIC-33.
- to change the criterion regarding when an investment is held exclusively with a view to its subsequent disposal from in the near future to within twelve months (paragraph 8).
- to remove the exclusion from equity accounting when an investee operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor (paragraph 8) and indicate that severe long-term restrictions on the ability to transfer funds to the investor may preclude significant influence (paragraph 5B).
- to require use of the equity method for an investment in an associate when an investor does not prepare consolidated financial statements because it does not have any subsidiaries (paragraph 8).
- to deal with the measurement of investments in associates in an investor's separate financial statements in IAS 27, Consolidation and Separate Financial Statements (paragraph 12).
- to incorporate the consensus in SIC-3, Elimination of Unrealised Profits and Losses on Transactions with Associates (paragraph 16B).

- to require that when financial statements of an associate used in applying the equity method are prepared as of a reporting date that is different from that of an investor, the difference shall be no greater than three months (paragraph 18).
- to require use of uniform accounting policies for like transactions and events in similar circumstances (paragraph 20).
- to require that the amount to be reduced to nil when an associate incurs losses shall include not only investments in the equity of the associate but also other long-term interests (paragraph 22) and to withdraw SIC-20, Equity Accounting Method — Recognition of Losses.
- to require additional disclosures (paragraphs 27-28B).

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International Accounting Standard IAS 28 (revised ~~2000~~ 200X)

Accounting for Investments in Associates

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APPENDIX:

Basis for Conclusions (Revisions 200X)

International Accounting Standard IAS 28

(revised ~~2000~~ 200X)

Accounting for Investments in Associates

The standards, which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the Preface to International Accounting Standards. International Accounting Standards are not intended to apply to immaterial items (see paragraph 12 of the Preface).

Scope

1. *This Standard ~~shall~~ should be applied by an investor in accounting by ~~an investor~~ for investments in associates. However, it does not apply to investments in associates held by venture capital organisations, mutual funds, unit trusts and similar entities that are measured at fair value in accordance with IAS 39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in those industries. When such investments are measured at fair value, changes in fair value are included in profit or loss in the period of the change.*
2. ~~[Deleted] This Standard supersedes IAS 3, Consolidated Financial Statements, in so far as that Standard deals with accounting for investments in associates.~~

Definitions

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

An associate is an entity ~~enterprise~~, including an unincorporated entity such as a partnership, in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

Control ~~(for the purpose of this Standard)~~ is the power to govern the financial and operating policies of an entity enterprise so as to obtain benefits from its activities.

Joint control is the contractually agreed sharing of control over an economic activity.

A subsidiary is an entity enterprise, including an unincorporated entity such as a partnership, that is controlled by another entity enterprise (known as the parent).

The equity method is a method of accounting whereby the investment is initially recorded at cost and adjusted thereafter for the post-acquisition change in the investor's share of net assets of the investee. ~~The income statement~~ ***The profit or loss of the investor includes*** reflects the investor's share of the profit or loss results of operations of the investee.

~~The cost method is a method of accounting whereby the investment is recorded at cost. The income statement reflects income from the investment only to the extent that the investor receives distributions from accumulated net profits of the investee arising subsequent to the date of acquisition.~~

Significant Influence

4. If an investor holds, directly or indirectly through subsidiaries, 20 per cent % or more of the voting power of the investee, it is presumed that the investor has ~~does have~~ significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly through subsidiaries, less than 20 per cent % of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

5. The existence of significant influence by an investor is usually evidenced in one or more of the following ways:
- (a) representation on the board of directors or equivalent governing body of the investee;
 - (b) participation in policy-making processes;
 - (c) material transactions between the investor and the investee;
 - (d) interchange of managerial personnel; or
 - (e) provision of essential technical information.

5A. An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity additional voting power or reduce another party's relative voting power over the financial and operating policies of another entity (potential voting rights). The existence and effect of potential voting rights that are currently exercisable or currently convertible, including potential voting rights held by other entities, are considered when assessing whether an entity has the power to have significant influence in the financial and operating policy decisions of the investee.

5B. Significant influence may be precluded when an investee is in legal reorganisation or in bankruptcy or operates under severe long-term restrictions on its ability to transfer funds to the investor.

Equity Method

6. Under the equity method, the investment is initially ~~recognised~~ ~~recorded~~ at cost and the carrying amount is increased or decreased to recognise the investor's share of the profits or losses of the investee after the date of acquisition. The investor's share of the profit or loss of the investee is included in the investor's profit or loss. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for ~~changes~~ ~~alterations~~ in the investor's proportionate interest in the investee arising from changes in the investee's equity that have not been included in the investee's profit

~~or loss~~ the income statement. Such changes include those arising from the revaluation of property, plant; and equipment and investments, and from foreign exchange translation differences ~~and from the adjustment of differences arising on business combinations~~. The investor's share of those changes is recognised directly in equity of the investor.

Cost Method

7. ~~[Deleted] Under the cost method, an investor records its investment in the investee at cost. The investor recognises income only to the extent that it receives distributions from the accumulated net profits of the investee arising subsequent to the date of acquisition by the investor. Distributions received in excess of such profits are considered a recovery of investment and are recorded as a reduction of the cost of the investment.~~

Application of the Equity Method **Consolidated Financial Statements**

8. *An investment in an associate ~~shall~~ **should** be accounted for ~~in consolidated financial statements~~ under the equity method except when:*
- ~~(a)~~ *the investment is acquired and held exclusively with a view to its subsequent disposal within twelve months from acquisition. ~~in the near future; or~~*
 - ~~(b)~~ *it operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.*

*Such investments ~~shall~~ **should** be accounted for in accordance with IAS 39, *Financial Instruments: Recognition and Measurement*, at fair value with changes in fair value included in profit or loss of the period of the change.*

- 8A. An investor accounts for an investment in an associate using the equity method irrespective of whether the investor also has investments in subsidiaries or whether it describes its financial statements as consolidated financial statements.

9. The recognition of income on the basis of distributions received may not be an adequate measure of the income earned by an investor on an investment in an associate because the distributions received may bear little relationship to the performance of the associate. Because ~~As~~ the investor has significant influence over the associate, the investor has a measure of responsibility for the associate's performance and, as a result, the return on its investment. The investor accounts for this stewardship by extending the scope of its ~~consolidated~~ financial statements to include its share of profits or losses ~~results~~ of such an associate ~~and so provides an analysis of earnings and investment from which more useful ratios can be calculated.~~ As a result, the application of the equity method provides more informative reporting of the net assets and ~~net profit or loss~~ income of the investor.

10. [Deleted]

11. An investor shall ~~should~~ discontinue the use of the equity method from the date that:

~~(a) it ceases to have significant influence over ~~in~~ an associate ~~but~~ retains, either in whole or in part, its investment; or and shall account for the investment in accordance with IAS 39, Financial Instruments: Recognition and Measurement, from the date that it ceases to be an associate.~~

~~(b) the use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.~~

11A. The carrying amount of the investment at ~~the~~ date that it ceases to be an associate shall ~~should~~ be regarded as its cost on initial measurement as a financial asset under IAS 39, Financial Instruments: Recognition and Measurement thereafter.

Separate Financial Statements of the Investor

12. ~~[Deleted] An investment in an associate that is included in the separate financial statements of an investor that issues consolidated financial statements and that is not held exclusively with a view to its disposal in the near future should be either:~~
- ~~(a) carried at cost;~~
 - ~~(b) accounted for using the equity method as described in this Standard; or~~
 - ~~(c) accounted for as an available-for-sale financial asset as described in IAS 39, Financial Instruments: Recognition and Measurement.~~
13. ~~[Deleted] The preparation of consolidated financial statements does not, in itself, obviate the need for separate financial statements for an investor.~~
14. ~~[Deleted] An investment in an associate that is included in the financial statements of an investor that does not issue consolidated financial statements should be either:~~
- ~~(a) carried at cost;~~
 - ~~(b) accounted for using the equity method as described in this Standard if the equity method would be appropriate for the associate if the investor issued consolidated financial statements; or~~
 - ~~(c) accounted for under IAS 39, Financial Instruments: Recognition and Measurement, as an available-for-sale financial asset or a financial asset held for trading based on the definitions in IAS 39.~~
15. ~~[Deleted] An investor that has investments in associates may not issue consolidated financial statements because it does not have subsidiaries. It is appropriate that such an investor provides the same information about its investments in associates as those enterprises that issue consolidated financial statements.~~

~~Application of the Equity Method~~

16. Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures ~~described set out in IAS 27, Consolidated and Separate Financial Statements and Accounting for Investments in Subsidiaries~~. Furthermore, the ~~broad~~ concepts underlying the ~~consolidation~~ procedures used in the acquisition of a subsidiary are also adopted on the acquisition of an investment in an associate.[†]

16A. A group's interest in an associate is the aggregate of the holdings in that associate by the parent and its subsidiaries (excluding those held by minority interests of subsidiaries). The holdings of the group's other associates or joint ventures are ignored for the purpose of applying the equity method. When an associate has subsidiaries, associates, or joint ventures, the profits or losses and net assets taken into account in applying the equity method are those recognised in the associate's consolidated financial statements (including the associate's share of the profits or losses and net assets of its associates and joint ventures), after any adjustments necessary to give effect to the investor's accounting policies (see paragraph 20).

16B. Profits and losses resulting from upstream and downstream transactions between an investor (including its consolidated subsidiaries) and an associate are eliminated to the extent of the investor's interest in the associate. Upstream transactions are, for example, sales of assets from an associate to the investor. Downstream transactions are, for example, sales of assets from the investor to an associate. Losses are not eliminated to the extent that the transaction provides evidence of an impairment of the asset transferred.

[†] See also SIC – 3, Elimination of Unrealised Profits and Losses on Transactions with Associates.

17. An investment in an associate is accounted for under the equity method from the date on which it ~~becomes~~ falls within the definition of an associate. On acquisition of the investment any difference (whether positive or negative) between the cost of ~~the investment acquisition~~ and the investor's share of the fair values of the net identifiable assets of the associate is ~~treated as goodwill and is~~ accounted for in accordance with IAS 22 (revised 1998), Business Combinations. ~~Goodwill relating to an associate is included in the carrying amount of the investment.~~ Appropriate adjustments to the investor's share of the profits or losses after acquisition are made to account for:
- (a) depreciation of the depreciable assets, based on their fair values ~~at the date of acquisition~~; and
 - (b) amortisation of ~~the goodwill difference between the cost of the investment and the investor's share of the fair values of the net identifiable assets.~~
18. ~~*When the financial statements of an associate used in applying the equity method are prepared as of a different reporting date from that of the investor, adjustments shall be made for the effects of significant transactions or events that occur between that date and the date of the investor's financial statements. In any case, the difference between the reporting dates of the associate and of the investor shall be no more than three months. The length of the reporting periods and any difference in the reporting dates shall be the same from period to period. The most recent available financial statements of the associate are used by the investor in applying the equity method; they are usually drawn up to the same date as the financial statements of the investor. When the reporting dates of the investor and the associate are different, the associate often prepares, for the use of the investor, statements as at the same date as the financial statements of the investor. When it is impracticable to do this, financial statements drawn up to a different reporting date may be used. The consistency principle dictates that the length of the reporting periods, and any difference in the reporting dates, are consistent from period to period.*~~

- 18A. The most recent available financial statements of the associate are used by the investor in applying the equity method. In the relatively few cases, when the reporting dates of the investor and the associate are different, the associate often prepares, for the use of the investor, financial statements as of the same date as the financial statements of the investor. When financial statements as of the same date as the investor cannot be prepared without undue cost or effort, financial statements of the associate as of a different reporting date may be used, provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or events that occur between the different reporting dates.
19. ~~[Deleted] When financial statements with a different reporting date are used, adjustments are made for the effects of any significant events or transactions between the investor and the associate that occur between the date of the associate's financial statements and the date of the investor's financial statements.~~
20. The investor's financial statements are ~~usually~~ prepared using uniform accounting policies for like transactions and events in similar circumstances. ~~In many cases, if~~ an associate uses accounting policies other than those ~~adopted by~~ of the investor for like transactions and events in similar circumstances, appropriate adjustments are made to conform the associate's accounting policies to those of the investor when ~~to~~ the associate's financial statements ~~when they~~ are used by the investor in applying the equity method. ~~If it is not practicable for such adjustments to be calculated, that fact is generally disclosed.~~
21. If an associate has outstanding cumulative preferred shares; that are held by outside interests other than the investor and classified as equity, the investor computes its share of profits or losses after adjusting for the ~~preferred~~ dividends on such shares, whether or not the dividends have been declared.

22. If, ~~under the equity method,~~ an investor's share of losses of an associate equals or exceeds ~~the carrying amount of its interest in the associate an investment,~~ the investor ~~ordinarily discontinues recognising including~~ its share of further losses. The interest in an associate is the carrying amount of the investment in the associate under the equity method plus items that, in substance, form part of the investor's investment in equity of the associate. For example, an item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension to, or deduction from, the entity's investment in equity. Such items may include preferred shares and long-term receivables or loans but do not include trade receivables or trade payables. The investment is reported at nil value. Additional losses are provided for to the extent that the investor has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the investor has guaranteed or otherwise committed. If the associate subsequently reports profits, the investor resumes including its share of those profits only after its share of the profits equals the share of net losses not recognised²

22A. Losses recognised under the equity method in excess of the investor's ordinary shares investment are applied to the other components of the investor's interest in an associate in the order of their seniority (ie priority in liquidation). The investor applies the requirements of IAS 39, Financial Instruments: Recognition and Measurement, to determine whether any additional impairment loss is recognised with respect to the other components of the investor's interest.

22B. After the investor's interest is reduced to nil, additional losses are provided for, and a liability is recognised, only to the extent that the investor has incurred obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the investor resumes recognising its share of those profits only after its share of the profits equals the share of net losses not recognised.

² See also SIC-20, Equity Accounting Method - Recognition of Losses.

Impairment Losses

23. If there is an indication that an investment in an associate may be impaired, an entity ~~enterprise~~ applies IAS 36, Impairment of Assets. In determining the value in use of the investment, an entity ~~enterprise~~ estimates:

- (a) its share of the present value of the estimated future cash flows expected to be generated by the investee as a whole, including the cash flows from the operations of the investee and the proceeds on the ultimate disposal of the investment; or
- (b) the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal.

Under appropriate assumptions, both methods give the same result. Any resulting impairment loss for the investment is allocated in accordance with IAS 36. Therefore, it is allocated first to any remaining goodwill (see paragraph 17).

24. The recoverable amount of an investment in an associate is assessed for each ~~individual~~ associate, unless the ~~an individual~~ associate does not generate cash inflows from continuing use that are largely independent of those from other assets of the reporting entity ~~enterprise~~.

Separate Financial Statements

24A. An investment in an associate shall be accounted for in the investor's separate financial statements in accordance with paragraphs 29, 30 and 33 of IAS 27, Consolidated and Separate Financial Statements.

24B. This Standard does not mandate which entities publish separate financial statements. Paragraph 24A applies when an entity prepares separate financial statements that purport to comply with International Financial Reporting Standards.

Income Taxes

25. ~~[Deleted]~~ Income taxes arising from investments in associates are accounted for in accordance with IAS 12, Income Taxes.

Contingencies

26. ~~[Deleted]~~ In accordance with IAS 37, Provisions, Contingent Liabilities and Contingent Assets, the investor discloses:
- ~~(a) its share of the contingent liabilities and capital commitments of an associate for which it is also contingently liable; and~~
 - ~~(b) those contingent liabilities that arise because the investor is severally liable for all the liabilities of the associate.~~

Disclosure

27. *The following disclosures shall ~~should be~~ made:*

- ~~(a) an appropriate listing and description of significant associates including the proportion of ownership interest and, if different, the proportion of voting power held; and~~
- ~~(b) the methods used to account for such investments.~~
- (a) the fair value of investments in associates for which there are published price quotations;***
- (b) summarised financial information of associates, including the aggregated amounts of assets, liabilities, revenues and profit or loss;***
- (c) the reasons why the presumption that an investor does not have significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, less than 20 per cent of the voting or potential voting power of the investee but concludes that it has significant influence;***

- (d) the reasons why the presumption that an investor has significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, 20 per cent or more of the voting or potential voting power of the investee but concludes that it does not have significant influence;
- (e) the reporting date of the financial statements of an associate, when such financial statements are used in applying the equity method and are as of a reporting date or for a period that is different from that of the investor, and the reason for using a different reporting date or different period;
- (f) the nature and extent of any restrictions on the ability of associates to transfer funds to the investor in the form of cash dividends, repayment of loans or advances (ie borrowing arrangements, regulatory restraint etc);
- (g) the unrecognised share of net losses of an associate, both for the period and cumulatively, if an investor has discontinued recognition of its share of losses of an associate.
28. Investments in associates accounted for using the equity method shall ~~should~~ be classified as long-term assets and disclosed as a separate item in the balance sheet. The investor's share of the after-tax profit or loss of such associates' investments shall ~~should~~ be disclosed as a separate item in the income statement. The investor's share of any discontinuing operations of such associates ~~extraordinary or prior period items~~ shall ~~should also~~ be separately disclosed.
- 28A. The investor's share of changes in the associate's equity recognised directly in equity by the investor shall be disclosed in the statement of changes in equity required by IAS 1, Presentation of Financial Statements.

28B. In accordance with IAS 37, Provisions, Contingent Liabilities and Contingent Assets, the investor shall disclose:

- (a) its share of the contingent liabilities of an associate for which it is also contingently liable; and**
- (b) those contingent liabilities that arise because the investor is severally liable for all liabilities of the associate.**

Effective Date

- 29. **This Standard becomes operative for annual financial statements covering periods beginning on or after 1 January 2003. Earlier adoption is encouraged. If earlier adoption affects the financial statements, an entity shall disclose that fact. Except for paragraphs 23 and 24, this International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1990.**
- 30. **[Deleted] Paragraphs 23 and 24 become operative when IAS 36 becomes operative — i.e. for annual financial statements covering periods beginning on or after 1 July 1999, unless IAS 36 is applied for earlier periods.**
- 31. **[Deleted] Paragraphs 23 and 24 of this Standard were approved in July 1998 to supersede paragraphs 23 and 24 of IAS 28, Accounting for Investments in Associates, reformatted in 1994.**

Appendix

Basis for Conclusions (Revisions 200X)

- A1. This Basis for Conclusions summarises the Board's considerations in reaching the conclusions in this Exposure Draft. Individual Board members gave greater weight to some factors than to others.
- A2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 28. The Board's objectives in the Improvements project are to reduce or eliminate alternatives, redundancies and conflicts within existing Standards, to deal with some convergence issues and to make other improvements. As the intention of the Improvements project is not to reconsider the fundamental approach to the accounting for investments in associates established by IAS 28, this Basis for Conclusions does not discuss requirements in IAS 28 that the Board has not reconsidered.

Accounting for investments by venture capital organisations, mutual funds, unit trusts and similar entities

- A3. No Standard specifically deals with the accounting for investments by venture capital organisations, mutual funds, unit trusts and similar entities. As a result, depending on the extent of control or influence over an investee, one of the following Standards is applied:
- (a) IAS 27 (revised 2000), Consolidated Financial Statements and Accounting for Investments in Subsidiaries,
 - (b) IAS 28 (revised 2000), Accounting for Investments in Associates, or
 - (c) IAS 31 (revised 2000), Financial Reporting of Interests in Joint Ventures.

- A4. The Board considered whether another approach is appropriate for these investments and concluded that it is. The Board noted that use of the equity or proportionate consolidation methods for investments by venture capital organisations, mutual funds, unit trusts and similar entities often produces information that is not relevant to their management and others and that fair value measurement produces more relevant information. The Board also noted that fair value information is often readily available for these investments.
- A5. In addition, the Board noted that there may be frequent changes to the level of influence or control for these investments and that financial statements are less useful if there are frequent changes in the method of accounting for an investment.
- A6. Accordingly, the Board decided to propose that investments by venture capital organisations, mutual funds, unit trusts and similar entities be excluded from the scope of IAS 28 and IAS 31, Financial Reporting of Interests in Joint Ventures, when they are measured at fair value in accordance with IAS 39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in the industries involved. The Board understands that use of fair value measurement is a well-established practice for these investments.
- A7. The Board decided, however, that if an investment qualifies as a subsidiary under IAS 27, the investment should be consolidated without exception. The Board concluded that if an investor controls an investee, the investee is part of a group and part of the structure through which the group operates its business and that consolidation of the investee is appropriate.

Recognition of losses

- A8. If an investor's share of losses of an associate equals or exceeds the carrying amount of an investment, IAS 28 and SIC-20, Equity Accounting Method — Recognition of Losses, require applying the equity method only until the carrying amount of the investment is reduced to nil, unless the investor has incurred obligations to the associate or has satisfied obligations of the associate that the investor has guaranteed or to which it is otherwise committed, whether funded or not. SIC-20 indicates that the carrying amount of an investment should include only the carrying amount of instruments that provide unlimited rights of participation in profits or losses and a residual equity interest in the investee.
- A9. The Board considered whether the base to be reduced to nil should be broader. The Board decided to propose requiring the base to include the carrying amount of an investment in equity shares plus other interests such as long-term receivables and therefore to withdraw SIC-20. The Board notes that, in circumstances in which an investee incurs losses, the substance of particular investments is that they are part of the investment in equity of the investee.
- A10. The Board also noted that if non-equity investments are not included in the base to be reduced to nil, an investor could restructure its investment to avoid recognising the loss under the equity method.

Proposed Improvements to International Accounting Standard IAS 40

Investment Property

International Accounting Standard IAS 40

(revised 200X)

Investment Property

[Note: For the purpose of this Exposure Draft, the new text is underlined and the deleted text is struck through.]

Invitation to Comment

The Board would particularly welcome answers to the questions set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Question 1

Do you agree that the definition of investment property should be changed to permit the inclusion of a property interest held under an operating lease provided that:

- (a) the rest of the definition of investment property is met; and
- (b) the lessee uses the fair value model set out in IAS 40, paragraphs 27-49?

Question 2

Do you agree that a lessee that classifies a property interest held under an operating lease as investment property should account for the lease as if it were a finance lease?

Question 3

Do you agree that the Board should not eliminate the choice between the cost model and the fair value model in the Improvements project, but should keep the matter under review with a view to reconsidering the option to use the cost model in due course?

Summary of Main Changes

The main changes proposed are:

- to amend the definition of investment property to permit a property interest held by a lessee under an operating lease to qualify as investment property provided that:
 - (a) the rest of the definition of investment property is met; and
 - (b) the lessee uses the fair value model set out in IAS 40, paragraphs 27-49.
- to require a lessee that classifies a property interest held under an operating lease as investment property to account for the lease as if it were a finance lease.

Contents

Limited revisions to International Accounting Standard IAS 40 Investment Property

[Marked-up text]

SCOPE Paragraph 2

DEFINITIONS 4

[Paragraph deleted] ~~13~~

MEASUREMENT SUBSEQUENT TO INITIAL RECOGNITION

Fair Value Model 26A

EFFECTIVE DATE 74A

APPENDIX:

Basis for Conclusions (Revisions 200X)

Limited revisions to International Accounting Standard IAS 40 Investment Property

[Marked-up text]

Scope [amend paragraph 2]

2. Among other things, this Standard deals with the measurement in a lessee's financial statements of investment property interests held under a lease accounted for as a finance lease, and with the measurement in a lessor's financial statements of investment property leased out under an operating lease. This Standard does not deal with matters covered in IAS 17, Leases, including:
- (a) classification of leases as finance leases or operating leases;
 - (b) recognition of lease income earned on investment property (see also IAS 18, Revenue);
 - (c) measurement in a lessee's financial statements of property interests held under a lease accounted for as an operating lease;
 - (d) measurement in a lessor's financial statements of property leased out under a finance lease;
 - (e) accounting for sale and leaseback transactions; and
 - (f) disclosure about finance leases and operating leases.

Definitions

[amend paragraph 4 and delete paragraph 13]

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

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.*

A property interest that is held by a lessee under an operating lease may be classified as investment property if and only if, in addition to the above condition being met, the lessee uses the fair value model set out in paragraphs 27-49 of this Standard. A lessee that uses the cost model set out in this Standard shall not classify property held under an operating lease as investment property.

13. ~~[Deleted] Under IAS 17, Leases, a lessee does not capitalise property held under an operating lease. Therefore the lessee does not treat its interest in such property as investment property.~~

Measurement Subsequent to Initial Recognition

Fair Value Model

[add new paragraph 26A]

26A. A lessee that classifies a property interest held under an operating lease as investment property shall account for that property interest as if it were subject to a finance lease by applying paragraphs 12-18, 23 and 24 of IAS 17, Leases.

Effective Date

[add new paragraph 74A]

74A. The amendments to paragraphs 2 and 4, the addition of paragraph 26A and the deletion of paragraph 13 become operative for annual financial statements covering periods beginning on or after 1 January 2003. Earlier adoption is encouraged. If earlier adoption affects the financial statements, an entity shall disclose that fact.

Appendix

Basis for Conclusions (Revisions 200X)

- A1. This Basis for Conclusions summarises the Board's considerations in reaching the conclusions in this Exposure Draft. Individual Board members gave greater weight to some factors than to others.
- A2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 40. The Board's objectives in the Improvements project are to reduce or eliminate alternatives, redundancies and conflicts within existing Standards, to deal with some convergence issues and to make other improvements. As the intention of the Improvements project is not to reconsider the fundamental approach to the accounting for investment property established by IAS 40, this Basis for Conclusions does not discuss requirements in IAS 40 that the Board has not reconsidered.

Property interests held under an operating lease

- A3. Paragraph 11 of IAS 17, Leases, requires a lease of land with an indefinite economic life to be classified as an operating lease, unless title is expected to pass to the lessee by the end of the lease term. This operating lease classification prevents the lessee from classifying its interest in the leased asset as an investment property under IAS 40. As a result, the lessee may not revalue its interest in the leased asset to fair value and report any change in fair value in net profit or loss. However, in some countries, interests in property (including land) are commonly or exclusively held under long-term leases. The effect of some of these leases differs very little from buying a property outright. As a result, some contend that such leases should be accounted for as finance leases and/or investment property.

- A4. The Board discussed a number of possible solutions to this issue. In particular, it considered deleting paragraph 11 of IAS 17, so that a long-term lease of land would be classified as a finance lease (and hence could qualify as an investment property) when the conditions for finance lease classification in paragraphs 3-10 of IAS 17 are met. The Board noted, however, that this would not resolve all cases encountered in practice. Some leasehold interests held for investment would remain classified as operating leases (eg leases with significant contingent rents or upwards-only rent reviews), and hence could not be investment property under IAS 40.
- A5. In light of this, the Board decided to amend IAS 40's definition of investment property so that a lessee's interest in property that arises under an operating lease could qualify as investment property. The Board decided to limit this amendment to entities that use the fair value model in IAS 40, because the objective of the amendment is to permit use of the fair value model for property interests held under an operating lease. Put another way, a lessee that uses the cost model for investment property would not be permitted to capitalise operating leases. The Board also decided to make the proposed change optional, ie to propose that a lessee that has an interest in property under an operating lease be allowed, but not required, to classify that property interest as investment property (provided the rest of the definition of investment property is met), on a property-by-property basis.
- A6. Finally, the Board decided to propose that when a lessee's interest in property held under an operating lease is accounted for as an investment property, the lease is accounted for as if it were a finance lease. The Board noted that if the lease were accounted for as an operating lease, the asset recognised by the lessee at inception would be limited to the amount of any prepaid rentals. Hence the amount recognised as an asset would vary depending on the balance chosen between prepaid and ongoing rentals. Furthermore, if this asset were to be revalued by applying the fair value model in IAS 40, the change in fair value recognised in the income statement would similarly depend on the balance chosen between prepaid and ongoing rentals. To overcome this effect, the Board proposes that the full amount of the lessee's asset is recognised and revalued, regardless of the pattern of lease payments. This is achieved by accounting for the lease as if it were a finance lease.

The choice between the cost model and the fair value model

- A7. The Board also discussed whether to remove the choice in IAS 40 of accounting for investment property under either a fair value model or a cost model.
- A8. The Board noted that IASC had included a choice in IAS 40 for two main reasons. The first was to give preparers and users time to gain experience with using a fair value model. The second was to allow time for countries with less-developed property markets and valuation professions to mature. The Board decided that more time is needed for these events to occur (IAS 40 is mandatory only for periods beginning on or after 1 January 2001). The Board also noted that requiring the fair value model would not converge with the treatment required by most of the liaison standard-setters. For these reasons, the Board decided not to eliminate the choice in the Improvements project, but rather to keep the matter under review with a view to reconsidering the option to use the cost model at a later date.

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