Accounting Standards Board august 2005 ED Statement

EXPOSURE DRAFT

STATEMENT OF PRINCIPLES

STATEMENT OF PRINCIPLES
FOR FINANCIAL REPORTING
PROPOSED INTERPRETATION
FOR PUBLIC BENEFIT ENTITIES

ACCOUNTING
STANDARDS
BOARD

For the convenience of respondents in compiling their responses, the text of the questions in the Invitation to Comment (see pages 21 to 24) can be downloaded (in Word format) from the relevant project page on the ASB Website (www.frc.org.uk/asb).

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

edsop@frc-asb.org.uk

Comments may also be sent in hard copy form to:

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Comments should be despatched to be received no later than 30th November 2005. All replies will be regarded as on the public record, unless confidentiality is requested by the commentator.

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PREFACE

INTRODUCTION

Statement of Principles for Financial Reporting

1 The Accounting Standards Board (the Board) issued the Statement of Principles for Financial Reporting (the Statement) in December 1999. This sets out the principles that the Board believes should underlie the preparation and presentation of general purpose financial statements.

2 The primary purpose of the Statement is to provide a coherent frame of reference to be used by the Board in the development and review of accounting standards and by others who interact with the Board during the standard-setting process. Publication of the principles was also intended to assist preparers and users of financial statements, as well as auditors and others, to understand the Board's approach to formulating accounting standards and the nature and function of information reported in general purpose financial statements.

3 The Statement is primarily intended to be relevant to the financial statements of profit-oriented entities in the private and public sectors. However, the Board believes that a common set of principles should underlie financial reporting by all entities. This will assist users in understanding financial statements regardless of the nature of the entity producing them and allow comparability, where appropriate, between all entities.

Proposed Interpretation for Public Benefit Entities

4 In May 2003, the Board issued a Discussion Paper 'Statement of Principles for Financial Reporting: Proposed Interpretation for Public Benefit Entities'. The Discussion Paper sought comments on the Board's views of the

application of the principles within the Statement to public benefit entities.

5 The Board received a number of helpful responses to the Discussion Paper and, as a result, has redebated a number of issues. In particular there was a great deal of support for the project.

6 In a number of areas the Exposure Draft differs from the Discussion Paper, as a result of those redeliberations. Neither the Discussion Paper, nor the Exposure Draft, attempt to redebate or update the Statement itself.

7 The Interpretation proposed within the Exposure Draft is intended to be relevant to the financial statements of all public benefit entities, regardless of their size, whether or not they make a surplus and whether they are private or public sector entities. However, it does not apply to profit-oriented entities, including any in the public sector.

8 The proposed Interpretation is intended to operate alongside the existing Statement expanding on the common underlying principles for public benefit entities, and therefore at the margin there should be no difference in financial reporting resulting from applying the Statement or the proposed Interpretation. As a result the Board has decided not to produce a list of entities that it believes meet the definition of a public benefit entity.

INTERNATIONAL DEVELOPMENTS AND CONVERGENCE

9 An EU Regulation requires all listed companies in the EU to prepare their consolidated financial statements in accordance with EU-adopted international accounting standards from 2005. International Financial Reporting Standards (IFRS) set by the IASB form the basis of these adopted standards. In addition other companies are permitted to choose to adopt the same framework, unless they are charitable companies, which must continue to

report under UK accounting standards. As a result it is expected that most public benefit entities will continue to prepare their financial statements in accordance with UK accounting standards and, where applicable, Statements of Recommended Practice (SORPs) that have been developed to provide guidance on the application of UK accounting standards in the circumstances of particular sectors.

10 The ASB is pursuing a programme of convergence between UK accounting standards and IFRS by issuing new UK standards that are based on IFRS. As a result, over time, all UK entities will be preparing their financial statements in accordance with standards based on the same core set of IFRS.

11 The IASB has on its agenda a joint project with the Financial Accounting Standards Board (FASB) in the USA which aims to develop a conceptual framework that combines and improves upon the existing frameworks. The initial focus is on concepts applicable to private sector business entities. At a later stage it is possible that the IASB will expand the project to include private not-for-profit entities. The ASB believes that the optimum approach would be for public benefit entities to be considered at the same time as profit-oriented entities. The ASB will feed its views into the IASB project and, in the longer term, reflect upon the implications of this work for the Statement and the proposed Interpretation.

International Public Sector Accounting Standards Board (IPSASB)

12 IPSASB* continues with its standards programme to develop and maintain International Public Sector Accounting Standards (IPSASs) for accounting by governmental bodies. Most of the standards currently in

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* *IPSASB was previously known as the Public Sector Committee (PSC) of the International Federation of Accountants (IFAC).*

issue are based on International Accounting Standards extant at 31 August 1997, although work has commenced on updating some standards for the IASB's recent improvements to existing IFRSs, such that they will be based on IFRS extant at 31 December 2003.

13 The scope of this Exposure Draft, which includes all public benefit entities, regardless of whether they are in the public or private sector, is wider than the work of the IPSASB, which covers only the public sector.

14 IPSASB's active work programme currently includes developing standards on public sector specific issues such as revenue from non-exchange transactions (including taxes and transfers), social policies of governments and budget reporting. IPSASB is now working towards the issue of Exposure Drafts in these areas.

15 IPSASB has not developed a conceptual framework, nor has it an active project to develop one; although this is a longer term goal. However, since IPSASB's standards are based on IFRS, it is implicit that IPSASs are based on the IASB's Framework.

16 During the development of both the Discussion Paper and the Exposure Draft the Board has had regard to pronouncements and proposals issued by IPSASB. For the issues discussed below a comparison to IPSASB requirements or proposals is noted.

MAIN ISSUES DEBATED IN DEVELOPING THE EXPOSURE DRAFT

17 Set out below are the main issues the Board considered in developing the Exposure Draft from the Discussion Paper. In debating these issues the Board took into account the views of respondents who commented on the Discussion Paper.

Funders and financial supporters as the defining class of user

18 The Statement identifies a defining class of user of financial statements. The reason for having a defining class of user is to identify a perspective from which to view the need for financial information: financial information required by the defining class should generally be provided by the financial statements and information that is not needed by the defining class need not be included in the financial statements.

19 For profit-oriented entities the defining class of user is present and potential investors. An investor is a provider of risk capital in expectation of a financial return on equity. The defining class of user is determined by reference to the types of information that are useful to users; it does not establish a duty of care where one does not already exist in law. It seeks to identify as the defining class of user the group whose information needs, if met, will also satisfy the general needs of all other users.

20 In the Discussion Paper the Board concluded that it is the funders and financial supporters of a public benefit entity who have a similar interest in its financial statements to that which investors have in the financial statements of a profit-oriented entity. This interest includes the effectiveness of the stewardship of management and the utilisation of resources.

21 Funders and financial supporters provide a source of cash or other resources that neither provides a direct return nor is provided in exchange for direct benefits (either goods or services), and may be compulsory (such as taxation).

22 Although a number of respondents agreed with this assessment, others made alternative suggestions for the defining class of user. In particular it was suggested that the defining class might be beneficiaries (particularly for charities) or citizens (particularly for public sector entities).

23 In relation to beneficiaries the Board agreed that they may be users of the financial statements of public benefit entities, analogous to the customer group referred to in the Statement. Some of the financial information requirements of beneficiaries might also overlap with those of the funders and financial supporters but, as noted above, an overlap in information requirements is to be expected between different groups of user. However, funders and financial supporters require information additional to that required by beneficiaries, for example to assist them in taking economic decisions relating to an entity.

24 In relation to citizens the Board noted that, for public sector entities, there is a high degree of concurrency between 'citizens' and 'funders and financial supporters'. However, the latter is a broader category; it includes *present and potential* funders and financial supporters. For an entity that receives funding from taxation the defining class of user includes all present and potential payers of any tax.

25 The Board continues to support its original conclusion that the defining class of user for the financial statements of a public benefit entity is the entity's present and potential funders and financial supporters. However, the Board reconsidered whether the defining class of user should include past funders and financial supporters. The Statement refers only to present and potential investors. A past funder or financial supporter would be an individual or an entity that had made a contribution in a prior financial year and where accountability for the contribution had ceased (ie there is no ongoing financial interest in the entity). The Board decided to delete references to 'past' funders and financial supporters, whilst noting that many past funders and financial supporters may also be present or potential funders and financial supporters, and therefore remain within the defining class of user.

26 There may be many people who are interested in the general performance of a public benefit entity, for example

how well it has met its public benefit objectives. Not all of these will be interested in the *financial* performance (and position) of the entity and many of those that are interested in the financial statements will also be interested in other information that assists in their assessment of the overall performance of the entity. The Statement (and therefore the proposed Interpretation) acknowledges that accompanying information can have an important role in assessing an entity's general performance, but it focuses primarily on the principles underlying financial performance (and position) as presented in an entity's financial statements. Chapter 7 discusses some aspects of accompanying information.

27 The proposed Interpretation has identified a defining class of user for the financial statements of a public benefit entity; other groups of users might be identified as the principal target for other performance–related information that a public benefit entity might produce.

28 IPSASB has not identified a defining class of user, but IPSAS 1 'Presentation of Financial Statements' notes that general purpose financial statements are intended to meet the needs of users who are not in a position to demand reports meeting their specific needs, and would include taxpayers, members of the legislature, creditors, suppliers, the media and employees.

Definitions of the elements of financial statements

29 The Discussion Paper proposed that the definitions of the elements of financial statements should not be re-expressed in order to make them applicable to public benefit entities, unless there was a clear need to adapt the terminology (for example, amending 'ownership interest' to 'residual interest' to address the point that most public benefit entities do not have owners, but nevertheless a residual interest still exists).

30 This proposal was based on the premise that the proposed Interpretation is an interpretation of the existing principles,

as set out in the Statement. It adds public benefit entity context to the Statement; it does not replace the Statement.

31 A number of respondents queried this approach and suggested that key phrases, such as 'service potential' should be incorporated into the definitions of assets and liabilities, rather being explained in the discussion of the definition. The Board considered these suggestions, and re-affirmed its view that a common set of principles should underlie financial reporting by all entities and therefore only minimal changes should be made to key definitions, otherwise the principles may appear divergent. However, where further interpretation of the principle is necessary for public benefit entities this should be provided in the discussion of the definitions.

32 IPSASB addressed the definitions of the elements of the financial statements in IPSAS 1, although they are not defined collectively in this way. IPSASB has introduced more differences in these definitions from those in IAS 1 'Presentation of Financial Statements', from which it is drawn, than those the Board proposes in the Exposure Draft. For example, IPSASB regards service potential as an alternative to future economic benefits rather than one of its components (along with net cash inflows) and has amended the definitions of assets and liabilities accordingly.

Liabilities: commitments to provide public benefits

33 The Board believes that the only area in which specific interpretation of the definition of a liability is required for public benefit entities relates to commitments to provide public benefits. Many other liabilities may arise, which are similar to those which may arise for profit-oriented entities, and no additional interpretation is required.

34 The identification of the point at which a liability for commitments to provide public benefits arises can be a difficult area for public benefit entities because many commitments do not stem from contractual agreements,

for which it is usually relatively straightforward to determine whether an entity is not free to avoid an outflow of resources. Public benefit entities do enter into commercial style contracts, but the Discussion Paper also addressed ‘commitments to provide public benefits’, which may, or may not, stem from a formal agreement. It was suggested that the nature of these commitments (ie whether general or specific) would be the first step in determining whether or not a liability had been incurred.

35 Not all respondents agreed with the proposals and this area has been revisited in some detail. The proposed Interpretation now focuses initially on the main definition and its explanation, which applies to all liabilities, and is followed by its interpretation in the context of commitments to provide public benefits. As in the Discussion Paper, commitments to provide public benefits are broken down into separate categories for this discussion.

36 A general commitment is a general or policy statement of intention and does not create a liability because it does not of itself create such an expectation that the entity making the commitment cannot withdraw from it, or amend the terms (ie it does not meet the definition of a liability).

37 The proposed Interpretation includes further classifications of specific commitments, depending partly on the nature (and substance) of the agreements involved. In some circumstances public benefits are provided under contractual arrangements or under performance-related grants, which are analogous to contracts. Such arrangements are usually executory contracts and a liability (or an asset) will arise only in respect of any unequally performed, or onerous, aspects of the arrangement.

38 For other specific commitments to provide public benefits, a liability arises when an entity can no longer avoid the transfer of resources. However, these arrangements can also be viewed as executory in nature because the objectives of the entity providing the goods or services are met when the

goods or services are provided (in this case no liability will usually arise because a loss/expense will be recognised as the goods or services are provided by the reporting entity). Even though these arrangements should be accounted for as executory contracts, it does not mean that this is on the basis of the underlying 'performance' of the recipient (since it is not a performance-related grant), but each time the exchange is partially performed, usually when the reporting entity provides goods or services.

39 The Board also considered whether a liability would arise immediately a commitment was given if it appeared to be an unconditional commitment to provide public benefits. Although in theory such circumstances cannot be precluded, in practice it is highly unlikely that they would occur because all public benefit entities will be operating within their objectives. The Board noted that there may be many commitments that give rise to an immediate obligation, but this does not necessarily lead to an immediate liability depending on the nature of the obligation (if it is an obligation to provide goods or services in exchange for meeting the reporting entity's objectives no liability will arise). The Board also queried whether any commitments are truly unconditional, or whether public benefit entities always implicitly include a condition that the activities of the beneficiary must continue to be consistent with the objectives of the giving entity.

40 This is an area that is also currently being considered by IPSASB. In January 2004, as the Public Sector Committee of the International Federation of Accountants, it published an Invitation to Comment (ITC) 'Accounting for Social Policies of Governments' which put forward a majority view that a liability does not arise until all eligibility criteria are satisfied. IPSASB is continuing its work on this project, but has decided to split it into three components dealing with different types of social benefits. Exposure Drafts are expected in due course.

41 At present there are some differences between the approaches taken by IPSASB and the proposed Interpretation. The proposed Interpretation notes that general political commitments do not give rise to a liability; the IPSASB ITC does not include a similar principle, although some of the discussion of collective goods and services reaches a similar conclusion.

42 The Statement, and therefore the proposed Interpretation, draws a distinction between events within and outside the control of the reporting entity. This distinction is not made in the IPSASB ITC and where satisfaction of the eligibility criteria is outside the control of the reporting entity, a conventional interpretation of the Statement would suggest that a liability should be recognised. The focus of IPSASB's work is narrower than the proposed Interpretation and the ITC considers in some detail particular types of payments made by governments as a result of their social policies, for example the old–age pension. The differing approaches, of IPSASB and the Board, to the principles underlying liability recognition can be illustrated by this example. The Board believes that, for many of the population, the 'promise' to pay an old-age pension is a general commitment that does not give rise to a liability. For existing pensioners the government is making such payments in line with its objectives and so a liability arises when a payment becomes due. In contrast, IPSASB puts forward the view that the pensioner must meet eligibility criteria, including remaining alive until each payment date; it is only once these criteria have been met that a liability arises (also on the due date). The IPSASB analysis is inconsistent with the Board's principles because whether or not the pensioner remains alive is outside the control of the reporting entity, and, as a result, if this were the sole consideration, a liability would have arisen for future pension payments at an earlier date. However, although the analysis of the issue is different the implications of ASB's and IPSASB's views on this issue are the same.

43 An alternative view is that grant-making differs from other types of commitments to provide public benefits and, except for those that are performance-related grants, does not legally, nor in substance, represent an executory contract for accounting purposes. This would be an exception from the principles outlined above. As such, those holding this alternative view suggest that grant-making commitments (other than performance-related grants) cannot contain an element of exchange and should be accounted for in accordance with FRS 12 'Provisions, Contingent Liabilities and Contingent Assets'*, which would require the recognition of a liability once an obligation arises.

Presentation of the residual interest and disclosure of restrictions over assets

44 The Discussion Paper noted that a public benefit entity may have more than one class of residual interest, particularly where restricted funds exist.

45 During the development of the Exposure Draft the Board decided that additional guidance was needed on what constitutes a class of residual interest. The Board noted that where restrictions exist over the application of assets it is appropriate to separately identify that portion of the residual interest, but it is also important that users of the financial statements understand which of the entity's assets are restricted. Therefore disclosure should also be given about the amount and nature of the assets subject to restrictions.

46 In relation to the unrestricted residual interest the Board also noted that the mere designation, by management, of a portion of the residual interest to reflect past expenditure or future intentions neither creates a different class of residual interest nor does it constitute a transaction and therefore

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* *In July 2005 the ASB issued an Exposure Draft that, in line with its convergence programme, proposed revising FRS 12 in line with revisions to the corresponding international standard.*

does not lead to recognition in the financial statements. However, management may choose to include a discussion of future intentions in the information accompanying the financial statements.

47 An alternative view is that the presentation in the financial statements of careful designation by management can be informative and should therefore not be precluded.

48 IPSASB has not specifically addressed these issues.

Notional transactions

49 The Discussion Paper included a brief consideration of 'notional transactions'.

50 The proposed Interpretation notes that if neither a transaction nor an event has occurred there will be no changes in the reporting entity's assets and liabilities and consequently no gain or loss to recognise.

Voluntary gifts

51 It was clear from respondents' comments that some guidance was necessary in relation to voluntary services, which are one aspect of voluntary gifts.

52 The Board noted that there are two broad categories of gifts that might be received; gifts of goods and gifts of services. Gifts of goods, which would include donations of cash, should be recognised based on their current value to the recipient (taking into account its expected utility to the recipient, including any restrictions placed on its use by the donor).

53 The receipt of voluntary services is an event that has taken place. In principle where an event has an economic impact on a reporting entity it should be reflected in the financial statements, but in practice other factors may sometimes prevent this. In particular, events should not be recognised

in the financial statements if it is not possible to measure their impact with sufficient reliability. The economic value of some gifts of services will be difficult to measure (other than at an arbitrary amount), for example, volunteers' time. Therefore the proposed Interpretation proposes that only those services meeting certain criteria should be recognised in the financial statements.

54 Gifts of services, which would include professional services as well as volunteer time, can be further sub-divided between those services that, if not provided voluntarily, would have been purchased and those that would not. The proposed Interpretation uses this distinction to determine which voluntary services should usually be recognised in the financial statements. Those services that would otherwise have been purchased should be recognised in the financial statements based on their value to the recipient (providing it can be reliably measured). For many voluntary services it is not clear that alternative services would have been purchased, even if the absence of the voluntary services would have severely affected the manner in which the entity conducts its business.

55 The proposed Interpretation suggests that disclosure should be provided, if practicable, of the nature of any voluntary services that are not recognised.

56 The Board does not agree with the position expressed in the IPSASB ITC 'Revenue from Non-exchange Transactions (including Taxes and Transfers)' that voluntary services should not in principle be recognised. However, it is understood that in progressing this project, IPSASB may have modified its view to permit the recognition of voluntary services, and require disclosure of those not recognised.

Capital contributions

57 In the following discussion a capital contribution is one that establishes an ongoing financial interest in an entity, it does

not include, for example, a grant (or other contribution) given to assist with the purchase of a fixed asset.

58 The Discussion Paper proposed that contributions from controlling parties in their capacity as controlling parties should not be accounted for as gains, but should be reported as increases in residual interest.

59 About half the respondents agreed with this proposal. Others disagreed, or asked for more information on how it was to be interpreted. As a result, the Board reconsidered whether public benefit entities could receive contributions analogous to the contributions from owners received by profit-oriented entities, and if so what the circumstances would be.

60 Capital contributions to public benefit entities can occur and they are those that establish a financial interest in the residual interest (being a right to participate in the residual interest). Such contributions may, or may not, be received from a controlling party.

61 This is an issue that is considered in the IPSASB ITC 'Revenue from Non-exchange Transactions (including Taxes and Transfers)' and the Board disagrees with IPSASB's view that for correct financial reporting a contributor should be permitted to designate a contribution as capital or revenue; otherwise the proposals appear consistent.

62 However, the Board believes that the existence of *any* contribution from a controlling party is significant to the financial performance and position of a public benefit entity and therefore it should be highlighted within the financial statements.

Capital grants (ie those given to finance the purchase of a fixed asset)

63 The Discussion Paper acknowledged that SSAP 4 'Accounting for Government Grants' is not wholly consistent with the definitions of the elements of financial statements in the Statement. Accordingly, it sought to move financial reporting forward in this area and propose a solution taking into account those definitions (in particular the definitions of a liability and a gain) and proposed a revised recognition point for capital grants in the performance statement.

64 The Discussion Paper also noted that accounting for government grants was the subject of work by the International Accounting Standards Board (IASB), which has confirmed that it intends to revise IAS 20.

65 One aspect of the proposals in the Discussion Paper that respondents were particularly uncomfortable with was the treatment, as a liability, of capital grants that must be repaid in the event of the subsequent sale of the asset financed by the grant. The Board has reviewed these proposals and retains the view that, in principle, a gain should be recognised when the conditions attached to the receipt of the grant have been met, but acknowledges that a liability for the repayment of a grant can usually be avoided by taking the decision to retain the asset that was financed by the grant.

66 For capital grants, although a requirement to repay a grant if the relevant asset is sold does amount to a condition, the actual repayment (assuming all other conditions have been met) of the grant could be avoided by deciding to retain the asset so this should not be a barrier to recognising the grant as a gain.

67 However, the Board notes that the receipt of a capital grant may indicate that, without the financial effect of the grant, the purchase of the relevant asset may not have satisfied the

economic criteria of the reporting entity. Therefore, an asset that has been wholly or partly financed by a capital grant should be tested for impairment on acquisition. The proposed Interpretation provides guidance on determining the value in use of assets held by public benefit entities, which in some instances may be based on the replacement cost of the service potential of the asset rather than the cash flows to be generated by the asset.

68 The principles underlying the accounting for capital grants apply equally to grants received from governmental sources and those from any other sources.

69 The IPSASB ITC 'Revenue from Non-exchange Transactions (including Taxes and Transfers)' also includes reference to grants receivable, which it defines as a sub-set of transfers. Much of the discussion focuses on when a recipient entity should recognise the grant receivable as an asset (where it involves the transfer of cash subject to conditions, it should be on receipt of the cash). The ITC puts forward the view that if, on receipt, the grant is subject to conditions a liability arises until the conditions are satisfied. However, the ITC does not appear to discuss the example of repayment in the event of the future sale of an asset funded by a grant (although it does meet their definition of a condition).

70 IPSAS 21 'Impairment of Non-Cash Generating Assets' does not identify the receipt of a grant towards the cost of the acquisition or construction of an asset as a trigger for an impairment review.

Budget reporting

71 As noted in paragraphs 7.19 and 7.20 the Board believes that users of general purpose financial reports can obtain useful information from a comparison between results and the relevant budget, but that since such information does not directly reflect transactions that occurred during a reporting period it does not, per se, provide information about the

entity's financial performance or financial position. Where management choose to present information relating to the entity's budget, it should form part of the accompanying information.

72 The Board notes that IPSASB has a project in progress considering Budget Reporting, and is expected to issue an Exposure Draft later this year. The Board believes that IPSASB's view that budget reporting forms part of general purpose financial statements requires further debate, including whether or not a comparison of actual to budget should be regarded as part of the primary financial statements or as accompanying information.

Business combinations

73 The Discussion Paper noted the Board's view that, similarly to business combinations involving profit-oriented entities, although true mergers do occur, the majority of business combinations involving public benefit entities are likely to be acquisitions where the entity existing after the combination is an enlarged version of one of the combining entities, not a new entity. However, a number of respondents agreed with an alternative view that business combinations between public benefit entities should more frequently be treated as mergers.

74 The Board continues to believe that the fact that a business combination involves public benefit entities does not of itself influence whether the business combination is accounted for as an acquisition or a merger, and that in the majority of cases it will be possible to identify an acquirer. The Board also noted that combinations involving entities under common control were already scoped out of the discussion on the relative likelihood of a combination being an acquisition or a merger because they would be group reconstructions; the existence of consolidated accounts provides evidence of a group for financial reporting purposes. Further, the management of an organisation should be able to be held responsible for the

outcomes from the combination; this may be difficult if a combination that has the characteristics of an acquisition has not been accounted for as such.

75 As a result the Board re-affirmed its previous conclusion that the majority of business combinations (other than those involving entities under common control) are likely to be acquisitions. Clearly in any individual case the facts of the particular circumstances need to be considered to determine whether the combination is an acquisition or a merger.

76 The Board also believes that it may be possible to improve the way in which to account for a true merger, for example by using 'fresh start' accounting. The Board looks forward to this topic being progressed internationally.

77 However, consistently with the proposals in the Discussion Paper there are some characteristics of business combinations between public benefit entities that have led the Board to propose a variation in the form of acquisition accounting to be applied. Where the business combination is in substance a gift of one business to another goodwill should not be recognised, but the fair value of the net assets (or liabilities) acquired should be recognised as a gain or loss.

78 IPSASs do not address accounting for combinations of entity.

INVITATION TO COMMENT

79 The Board is requesting comments by 30 November 2005. The Board would welcome responses not only from its UK and Republic of Ireland constituents, but also from other jurisdictions where similar issues are faced in financial reporting by public benefit entities.

80 Comments are invited on any aspect of the Exposure Draft, but would be particularly welcome on the following issues:

Liabilities

(a) Do you agree with the discussion of liabilities in the context of 'commitments to provide public benefits'? In particular:

   (i) Do you agree that performance-related grants are analogous to contracts? If not, why not?

   (ii) Do you agree that, for non-performance-related commitments (similarly to assets), benefits can be obtained by achieving an entity's objectives such that a commitment to provide public benefits will have the substance of an executory contract and liabilities will not usually arise until the transfer of resources become due? If not, why not?

(b) Do you believe that there are circumstances where an entity has entered into a commitment in furtherance of its objectives, but nevertheless a liability has been created when the commitment was given? If so, please describe the circumstances and characteristics of such a liability?

Residual interest and restricted assets

(c) Do you agree that information should be provided in the financial statements to explain the amount and nature of any assets that are subject to restrictions over their application? If not, why not?

(d) Do you agree that the mere designation of a portion of the residual interest does not result in a transaction for recognition in the financial statements, but could instead be discussed in accompanying information? If not, why not?

Business combinations

(e) Do you agree that, having taken the circumstances of business combinations between public benefit entities into account, it is likely that the majority (other than those involving entities under common control) will be acquisitions? If not, why not?

Capital contributions

(f) Do you agree that capital contributions (being those establishing a financial interest in the residual interest of a public benefit entity) should not be accounted for as gains, but as an increase in the residual interest? If not, why not?

(g) Do you agree that any resources received from a controlling party, whether or not they are capital contributions, should be disclosed due to the impact they have on the financial performance and financial position of the reporting entity? If not, why not?

Capital grants

(h) Do you agree that capital grants should be recognised as gains when any conditions attaching to their receipt are met, and that assets financed by capital grants should be subject to an impairment test once they are ready for use? If not, why not?

(i) In particular, do you agree that the existence of a clause requiring the repayment of a capital grant in the event that the asset it financed is sold is not a barrier to recognising the grant as a gain? If not, why not?

Voluntary gifts

(j) Do you agree that those voluntary services that would have been purchased, if not given voluntarily, should be recognised based on the value to the recipient

(providing it can be reliably measured), but that otherwise voluntary services should not be recognised in the financial statements? If not, why not and how would you resolve any measurement issues that might arise?

Other

(k) Do you believe that any other guidance or re-expression of the principles is needed? If so, please provide details.

81 As with the Discussion Paper the ASB's Committee on Accounting for Public-benefit Entities (CAPE)* led the development of the Exposure Draft and the Board gratefully acknowledges its continuing contribution to its work.

OTHER ASB PROJECTS

82 The ASB is undertaking a review of the accounting for heritage assets. The project aims to develop practical proposals that will result in greater consistency and transparency in the financial reporting of heritage assets. It is expected that the first output from the project will be a Discussion Paper. IPSASB has signalled its intention to also issue a Discussion Paper, which will be based on the ASB's work.

* *Formerly the Public Sector and Not-for-profit Committee (PSNC).*

INTRODUCTION

PURPOSE

1 The proposed Interpretation of the Statement of Principles for Financial Reporting (the proposed Interpretation), for public benefit entities, sets out the principles that the Accounting Standards Board (the Board) believes should underlie the preparation and presentation of general purpose financial statements of public benefit entities*.

2 The principles in the proposed Interpretation are consistent with those relevant to profit-oriented entities, as set out in the Statement of Principles for Financial Reporting (the Statement). Many of the principles are exactly the same as those that are relevant to profit-oriented entities. Any re-expression, change of emphasis or additions to the principles are designed to make them more relevant to public benefit entities and have only been made to clarify their application in situations specific to public benefit entities. The proposed Interpretation also provides an explanation of how the principles apply to public benefit entities. Those principles that have been re-expressed in the proposed Interpretation are detailed in Appendix 1, together with a brief explanation.

3 The primary purpose of articulating the application of the principles to public benefit entities is to provide a coherent frame of reference to be used in the development of Statements of Recommended Practice (SORPs)† or other

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* *The term 'public benefit entities' is explained in paragraph 10.*

† *SORPs are recommendations on accounting practices for specialised sectors. They supplement accounting standards and other legal and regulatory requirements in the light of the special factors prevailing or transactions undertaken in a particular sector. SORPs are not issued by the ASB, but by industry or sectoral bodies recognised for the purpose by the ASB. At present there are four SORPs relating to the public benefit sector addressing local authorities, higher and further education institutions, registered social landlords and charities.*

sector specific guidance for public benefit entities and to assist preparers and auditors faced with new or emerging issues. Nothing in the proposed Interpretation overrides the requirements of existing accounting standards or SORPs.

4 The prescription of accounting requirements for the public sector in the United Kingdom is a matter for the Government. Where entities in the public sector prepare annual reports and accounts on commercial lines, the Government's requirements may or may not refer specifically either to accounting standards or to the need for the financial statements concerned to give a true and fair view. However, when they do, the Government's requirements accord with the principles underlying the Board's pronouncements subject to such adaptations as are necessary in the public sector context.

STATUS

5 The Statement is not an accounting standard, nor does it have a status that is equivalent to an accounting standard. It therefore does not contain requirements on how financial statements should be prepared or presented.

6 Much of the wording in the proposed Interpretation is based upon the Statement. This document is intended to supplement, not replace, that Statement. It should, therefore, be read in conjunction with it.

7 In order to ensure that there is adequate context for the information on the application of the principles to public benefit entities some of the material in the Statement has been repeated in the proposed Interpretation. However, it should not be assumed that where material has been omitted it is not relevant to public benefit entities. Appendix 2 provides a comparison with the Statement highlighting the source of material and those paragraphs of the Statement that have not been repeated.

SCOPE

Types of entity

8 The Statement is intended to be relevant to the financial statements of profit-oriented entities. This is regardless of whether they are private or public sector entities.

9 The principles in the proposed Interpretation are intended to be relevant to the financial statements of public benefit entities, regardless of their size, whether or not they aim to make a surplus and whether they are private or public sector entities*.

10 Public benefit entities are reporting entities whose primary objective is to provide goods or services for the general public or social benefit and where any risk capital† has been provided with a view to supporting that primary objective rather than with a view to a financial return to equity shareholders.

11 The term 'public benefit entities' does not necessarily imply that the purpose of the entity is to exist for the benefit of the public as a whole. For example, many public benefit entities exist for the direct benefit of a particular group of people, although it is possible that society as a whole also benefits indirectly. The important factor is what the primary purpose of such entities is, and that it is not an economic benefit to investors. Organisations such as mutual insurance companies, other mutual co-operative entities and clubs that provide dividends or other economic benefits directly and proportionately to their owners, members or participants are not public benefit entities.

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* *Both the Statement and the proposed Interpretation use the terms 'public' and 'private' in this context as mutually exclusive and to encompass between them all entities.*

† *Risk capital (for example given up in the purchase of equity shares) is provided by investors.*

12 The use of the term does not mean that all entities that do not make a profit are for the public benefit. Neither does the term imply that all entities that make a profit (or surplus) are not for the public benefit. Furthermore certain 'public benefit entities' may aim to make a profit from some of their activities, for example housing associations or the trading arm of a charity, which will be utilised in furtherance of the entity's primary objective. It is possible that an entity could undertake some activities that are intended to make a surplus, without the entity as a whole being profit-oriented*.

13 Public benefit entities may have contributions in the form of equity, even though the entity does not have a primary profit motive. However, because of the fundamental nature of public benefit entities, any such contributions are made by the equity holders of the entity primarily for the provision of goods or services rather than with a view to a financial return for themselves†. This is different from the position of lenders; loans do not fall into the category of equity.

14 There is no exhaustive list of entities that are public benefit entities.

15 The principles contained in the Statement should be assumed to be relevant to entities that are not public benefit entities, without interpretation. These might include some public sector entities. However, at the margin there should be no difference in the accounting solution regardless of whether the Statement or the proposed Interpretation has been applied.

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* *Where a public benefit entity has a discrete division that is profit-oriented it may be useful to refer to the Statement in relation to that division, even though the proposed Interpretation applies to the entity as a whole. Similarly, the proposed Interpretation would not be directly relevant to any subsidiaries of public benefit entities that are not public benefit entities themselves.*

† *It does not follow that all contributions from funders and financial supporters are in the form of risk capital.*

Types of financial report

16 Financial information takes many different forms. However, the Statement categorises financial information into three broad headings. These categories are:

- special purpose financial reports;
- general purpose financial reports; and
- other financial information.

17 General purpose financial reports includes general purpose financial statements, for example the annual financial statements.

18 The primary focus of the proposed Interpretation for public benefit entities is on those financial statements that are required to give a true and fair view of the reporting entity's financial performance and financial position. For most entities, those statements will be their full annual financial statements. However, where the requirement to present a true and fair view is expressed in another form, for example 'presents fairly', the proposed Interpretation still applies.

19 The principles in the proposed Interpretation have been developed in the context of entities that prepare accruals based financial statements. Accordingly, the Statement is not intended to be relevant to receipts and payments accounts and other non-accruals based general purpose financial statements, which would not give a true and fair view of the reporting entity's financial performance and financial position.

20 Whilst the Statement does not address to any significant extent other types of general purpose financial report, it will be relevant to such reports insofar as they provide financial information that is intended to be consistent with the financial statements.

Legal requirements

21 The financial statements of public benefit entities are subject to legal requirements. Such requirements may vary substantially between sub-sets of public benefit entities both in terms of the level of prescription (ie general or very specific) and in terms of quantity/sources. In order not to deny the proposed Interpretation the opportunity to assist in the development of legal requirements, it has not been developed within the constraints imposed by legislation.

REVISIONS TO THE STATEMENT

22 The Statement may be revised from time to time in the light of the Board's experience of working with it and in response to developments in accounting thought. The proposed Interpretation may also be revised from time to time.

CHAPTER 1:

THE OBJECTIVE OF FINANCIAL STATEMENTS

Put simply, the objective of financial statements is to provide information that is useful to those for whom they are prepared. However, the objective needs to be expressed more precisely if it is to be of any use in determining the form and content of financial statements. This chapter does that by considering the persons for whom financial statements are prepared, the information needs of such persons and the role that financial statements play in meeting those needs.

PRINCIPLES

- The objective of financial statements is to provide information about the reporting entity's financial performance and financial position that is useful to a wide range of users for assessing the stewardship of the entity's management and for making economic decisions.

- That objective can usually be met by focusing exclusively on the information needs of funders and financial supporters, the defining class of user.

- Funders and financial supporters need information about the reporting entity's financial performance and financial position that is useful to them in helping to evaluate the proper and efficient use of the entity's resources and in assessing the entity's cash needs and its financial adaptability.

EXPLANATION

THE OBJECTIVE OF FINANCIAL STATEMENTS

Useful to a wide range of users

1.1 The Statement notes that many people may have an interest in the financial information of an entity. Certain bodies, such as the regulators of public benefit entities, may have the power to insist on the preparation of special purpose financial reports. However, others will need to rely on general purpose financial reports, such as financial statements. These persons are referred to as the 'users'.

Useful for making economic decisions

1.2 The persons potentially interested in an entity's financial statements need information on that entity for a variety of purposes. For public benefit entities the groups of users that are interested in an entity's financial statements are largely consistent with those described in the Statement. Some exceptions and clarifications are discussed below:

(a) *Present and potential investors*. Public benefit entities rarely have such investors; therefore this class of user has been replaced with *funders and financial supporters*.

(b) *Present and potential funders and financial supporters (hereafter generally referred to simply as 'funders and financial supporters')*. Providers of resources are interested in information that helps them to assess how effectively management has fulfilled their stewardship role. They are also interested in information about the utilisation of the resources they supplied to the entity that might be useful in taking decisions about resources they may choose, or be required, to supply in the future.

(c) *Lenders*. Lenders are interested in information that helps them to assess whether their loans will be repaid, and related interest will be paid, when due. Similarly,

potential lenders are interested in information that helps them to decide whether to lend to the entity and on what terms.

(d) *Beneficiaries/customers.* Beneficiaries and customers are interested in information about the entity's continued existence. That is especially so when they have a long-term involvement with, or are dependent on, the entity. Beneficiaries and customers are also interested in how resources have been applied by the entity in meeting its objectives.

(e) *Governments and their agencies, including regulators.* Governments and their agencies are interested in the allocation of resources and, therefore, the activities of entities. They may also have specific regulatory (or intermediary) roles, through which they aim to give public confidence in the operations of the entities they regulate, perhaps performing a scrutiny role on behalf of the funders and financial supporters, or the general public. They require information that assists them in regulating the activities of entities and for example, for providing a basis for national statistics. Some of this information is obtained through special purpose financial reports, which will often need to be able to demonstrate consistency with published general purpose financial reports, such as financial statements.

(f) *The public.* The interest the public may have in the financial statements of a public benefit entity will vary from that described in the Statement. For example, as part of the broad accountability of public benefit entities, the public may be interested in the quality of management's stewardship and in the relative allocation of resources between competing priorities. For a number of public benefit entities the public will be the funders and financial supporters of the entity.

1.3 Although those potentially interested in an entity's financial statements need that information for a variety of purposes,

the Statement concludes that all the purposes involve taking economic decisions. The economic decisions made by users of the financial statements of profit-oriented entities may include whether to hold or sell their investments. They might also include whether to reappoint or replace the management of the entity. For public benefit entities, certain users will have the ability to make similar economic decisions. For example, funders and financial supporters may vary the level of financial support based on how effectively management have fulfilled their role. This might include a decision about whether to commence supporting an entity.

1.4 However, some users, for example, the public/taxpayer in relation to a local authority, will not have the same ability to make direct economic decisions. Although they may have the ability to make certain decisions, such as voting, that will only indirectly influence the level of resources contributed to entities. Therefore, some users will sometimes be interested in the financial statements primarily in order to assess the adequacy of stewardship exercised by the entity's management.

Assessing stewardship

1.5 Stewardship plays an important role in the preparation of financial statements by public benefit entities. Accountability to a public benefit entity's stakeholders for the use of funds and the safekeeping of its resources is often of paramount importance and there may be a wide range of people having such an interest in the activities of the entity. For example, accountability to the public for the collection of taxation and its use in the provision of public goods and services is enshrined in public sector reporting. Therefore, a key objective of financial statements is the provision of information to assist in a user's assessment of the efficient and effective use of funds and other resources.

1.6 In order for users to make a full assessment of the stewardship of an entity (perhaps including an assessment

of the extent to which its public benefit objective has been met) additional information is likely to be required. Some of this information may accompany the financial statements, but does not form part of the financial statements. This is known as accompanying information and is discussed in Chapter 7.

Information on financial performance and financial position

1.7 There is overlap in the financial information that is required by users: all are interested in the financial performance and financial position of the entity as a whole. General purpose financial statements focus on this common interest of users and are the principal means of communicating accounting information on an entity to interested parties.

The limitations of financial statements

1.8 Financial statements do not seek to meet all the information needs of users: users will usually need to supplement the information they receive from financial statements with information from other sources. Financial statements have various inherent limitations* that mean that some information on the financial performance and financial position of the reporting entity can be provided only by general purpose financial reports other than financial statements (for example, a description of the environment in which the reporting entity operates and the strategies it has adopted is better included in the accompanying information). Those users with the authority to obtain special purpose financial reports might also utilise that authority to supplement the information in the financial statements.

1.9 The need to supplement the financial statements with other information is at least as important for public benefit entities as for profit-oriented entities. In assessing the efficient and

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* *Including the degree of aggregation, the focus on the financial effects of transactions and events and that they are largely historical.*

effective use of resources, the user is likely to need information in addition to that reported in a conventional presentation of financial performance and financial position. For example information in the material accompanying the financial statements, such as the operating and financial review, might be needed in order to put the numerical information in the financial statements into context. Such information might include qualitative and quantitative information on services provided by the entity during the year.

1.10 Many public benefit entities also utilise other forms of presentation, which may include financial information and may or may not be provided with the financial statements. One example might be a comparison of actual results to the budget, which might provide information on whether an entity has fulfilled its spending promises. They might also use methods of communication other than the financial statements to provide financial information, particularly to classes of user other than the defining class.

FUNDERS AND FINANCIAL SUPPORTERS AS THE DEFINING CLASS OF USER

1.11 The Statement notes that, in preparing financial statements of profit-oriented entities, the rebuttable assumption is that financial statements that focus on the interest that investors have in the reporting entity's financial performance and financial position will, in effect, also be focusing on the common interest that all users have in that entity's financial performance and financial position.

1.12 However, public benefit entities often have no such investors (ie shareholders) and for those entities that do have shareholders, there may be no rights to participate in any surpluses or on winding up*. For public benefit entities

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* *In the event of a winding up any remaining net assets would often be dealt with in accordance with the governing instrument of the entity. Usually this would involve the transfer of the net assets to another public benefit entity with similar objectives.*

funders and financial supporters are similar to investors in profit-oriented entities in terms of their information requirements.

1.13 The defining class of user for the financial statements of public benefit entities is the funders and financial supporters. They provide a source of cash or other resources without the incentive of a return, either a direct return (like interest paid on a loan) or in the form of an exchange for direct benefits (goods or services), for themselves. The funder and financial supporter generally provides taxation, grants or donations to the entity. The defining class of user includes the present and potential funders and financial supporters of the entity. A present funder or financial supporter would include an individual or entity that had made a contribution in the past if that contribution created an ongoing financial interest.

1.14 There are differences between a 'financial supporter' and a 'funder'. A financial supporter is someone who has made a conscious decision to contribute, whereas this might not be true of a funder, such as a taxpayer. A lender, in his capacity as a provider of debt capital on which he receives a return, is neither a funder nor a financial supporter.

1.15 Where a public benefit entity has 'members' who are required to make a financial contribution in order to be admitted to the membership, they should be considered as financial supporters where the value of the contribution is unlikely to represent the fair value of the benefits available from membership (ie it is at least partly a mechanism to provide financial support, not the purchase of goods or services). As a result, to the extent that contributions are financial support, they should be recognised as revenue when received.

1.16 For many public benefit entities, funds are not received directly from their source, but are passed on through intermediaries (for example government entities providing grants). Often such intermediaries will also be regulators,

and may have a statutory right to require certain information to be published in the financial statements. However, this information should be regarded as special purpose as it will not necessarily meet the information requirements of a general user of the financial statements (for example, where it relates to an amount of expenditure incurred under a specific piece of legislation). Therefore, there is a need to look through intermediary financial supporters to the original source, for example in many cases this will be the taxpayer, in order to ensure that financial statements are prepared to provide general purpose rather than special purpose information. It may also be the case that the intermediary performs a scrutiny role on behalf of the ultimate source of the resources, acting as a judge of performance where the ultimate funder or financial supporter may not have the requisite skills or opportunity to do so.

THE INFORMATION REQUIRED BY FUNDERS AND FINANCIAL SUPPORTERS

Financial performance

1.17 Information on financial performance, amongst other things, provides an account of stewardship of management and is useful in assessing the past and anticipated performance of the entity.

1.18 In the case of public benefit entities, stewardship is a particularly important part of reporting to users. Users require information to hold management to account for the safekeeping of the entity's resources and for their proper and efficient use.

Financial position

1.19 An entity's financial position encompasses the economic resources it controls, its financial structure, its liquidity and solvency, its risk profile and risk management approach, and its capacity to adapt to changes in the environment in which

it operates. Information about the economic resources controlled and the use made of them in the past helps in assessing the stewardship of management.

Cash needs

1.20 Information on the ways in which an entity uses cash provides an additional perspective on financial performance that is largely free from allocation and valuation issues and is relevant to an assessment of its future cash needs.

1.21 Information on the generation and use of cash will be of importance for public benefit entities. In certain cases, the entity may have a limit imposed on the amount of cash that it has authority to spend each year. Therefore, information on the use of cash may be needed to demonstrate accountability and the effective use of funds.

Financial adaptability

1.22 An entity's financial adaptability is its ability to take effective action to alter the amount and timing of its cash flow so that it can respond to unexpected needs or opportunities.

1.23 Financial adaptability can help an entity mitigate the risks associated with its activities, which in turn helps it survive during a time of low cash flows.

CHAPTER 2:

THE REPORTING ENTITY

It is important that entities that ought to prepare and publish financial statements, do, in fact, do so and that those financial statements report on all relevant activities and resources. This chapter focuses on these issues – in other words, on identifying and circumscribing the reporting entity.

PRINCIPLES

- An entity should prepare and publish financial statements if there is a legitimate demand for the information that its financial statements would provide and it is a cohesive economic unit.

- The boundary of the reporting entity is determined by the scope of its control. For this purpose, first direct control, and secondly, direct plus indirect control are taken into account.

EXPLANATION

There are few fundamental differences between the principles and explanation relevant to profit-oriented entities, as expressed in Chapter 2 of the Statement, and their interpretation for public benefit entities. Therefore much of what follows is a summary of the discussion in Chapter 2 of the Statement, which should be referred to for a full understanding. Additional explanation specific to public benefit entities has been added covering assets under an entity's stewardship but not control.

ENTITIES THAT SHOULD PREPARE AND PUBLISH FINANCIAL STATEMENTS

2.1 It is essential that entities that ought to prepare and publish financial statements, do, in fact, do so. For similar reasons, if

there is no justification for an entity to prepare and publish financial statements, it should not be required to do so.

2.2 For the preparation of financial statements to be justified in any particular case, there needs to be a legitimate demand for the information that the financial statements would provide. This means, inter alia, that the information provided by the financial statements will need to be useful and that the benefits to be derived by providing the financial statements will need to exceed the costs of doing so.

2.3 The financial statements of an entity will report on the entity's transactions and on other events that affect its financial performance and financial position. However, if the information provided by the financial statements is to be useful, the entity that is the subject of the financial statements (the reporting entity) needs to be a cohesive economic unit. This ensures accountability – the reporting entity is held to account for all the things it can control – and it gives the reporting entity a determinable boundary – because activities and resources are either within its control or outside its control.

THE BOUNDARY OF A REPORTING ENTITY

2.4 The control an entity exerts can be direct or indirect.

(a) An entity has direct control of an asset if it has the ability in its own right to obtain future economic benefits* embodied in that asset and to restrict others' access to those benefits.

(b) An entity indirectly controls an asset if it has control of an entity that has direct control of the asset.

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* *The future economic benefits to which a public benefit entity might have access are discussed in Chapter 4.*

2.5 Direct control is used to determine the boundary of the reporting entity that prepares single entity financial statements. Direct plus indirect control is used to determine the boundary of the reporting entity that prepares consolidated financial statements.

2.6 It may be that, although an entity can influence another entity, it does not control it. Such entities do not comprise a single reporting entity.

WHAT IS CONTROL?

2.7 Control has two aspects: the ability to deploy the economic resources involved and the ability to benefit (or to suffer) from their deployment. To have control, an entity must have both these abilities.

2.8 Control in the context of assets and liabilities is considered in more detail in Chapter 4, which provides further details on the interpretation of "economic benefits" in the context of public benefit entities, in particular noting that access to future economic benefits includes the provision or goods and/or services to the benefit of the entity's beneficiaries.

CONTROLLING AN ENTITY

When does one entity control another?

2.9 An entity will have control of a second entity if it has the ability to direct that entity's operating and financial policies with a view to gaining economic benefit from its activities (which might be achieved through concurrence of objectives) or being exposed to significant risks inherent in the activities. Control of another entity need not involve share ownership.

2.10 There is no single piece of evidence that is proof of an investor's control in all circumstances, although evidence that will help to determine whether control exists can be obtained by considering:

(a) the respective rights held;

(b) the inflows and outflows of benefit; and

(c) exposure to risk – how and to what extent the investor suffers or gains from variability of outcome.

2.11 In the absence of any other factors, an agreement to provide funding would not be expected to constitute control.

2.12 In some circumstances a public benefit entity may be the trustee of charitable funds. Depending on the circumstances of the case it may be possible that the charitable funds form part of the reporting entity, because the trustee controls the charitable funds, particularly if the objectives are concurrent.

Powers of veto and reserve powers

2.13 Control implies the ability to restrict others from directing the financial and operating policies of the controlled entity. Powers of veto and reserve powers are unlikely to form the sole basis of control because they do not provide a basis for deploying the resources nor do they ensure the corresponding flows of benefit.

Predetermined operating and financial policies

2.14 An entity whose operating and financial policies are predetermined will be controlled by another entity if that other entity gains the benefits arising from the former's net assets and is exposed to the risks inherent in them (ie the variability of outcome).

Latent control

2.15 If an entity has the ability to control another entity, it is usually presumed to be exercising control, even if such control is not apparent.

Management but not control

2.16 Control needs to be distinguished from management. If an entity manages a second entity on its own behalf, then it controls the second entity because it has the two abilities referred to in paragraph 2.7. On the other hand, if an entity manages the second entity on behalf of another party, it is not exposed to the benefits arising from, or risks inherent in, the activities of the second entity because the manager's interest in the managed entity is normally limited to its fee. As such, it does not have the second ability referred to in paragraph 2.7 and therefore does not have control of the second entity.

ASSETS UNDER AN ENTITY'S STEWARDSHIP BUT NOT CONTROL

2.17 A number of public benefit entities have a stewardship role for assets that they do not control, for example residents' valuables held by a local authority care home or artwork on loan for an exhibition. Since the boundary of the reporting entity is based on control, such assets should not be reflected in the balance sheet of the reporting entity. Even if a stewardship arrangement does not pass the control test, appropriate disclosure about the arrangement is necessary to indicate the nature and extent of the entity's responsibilities in that regard. Nevertheless, in some circumstances an entity may be required to prepare separate financial information relating to the assets under its stewardship, but not control.

CHAPTER 3:

THE QUALITATIVE CHARACTERISTICS OF FINANCIAL INFORMATION

In deciding which information to include in financial statements, when to include it and how to present it, the aim is to ensure that financial statements yield information that is useful. This chapter considers the qualities of financial information that make it useful.

PRINCIPLES

- Information provided by financial statements needs to be relevant and reliable and, if a choice exists between relevant and reliable approaches that are mutually exclusive, the approach chosen needs to be the one that results in the relevance of the information provided being maximised.

- Information is relevant if it has the ability to influence the economic decisions of users, or their assessment of the effectiveness of the stewardship of management, and is provided in time to influence those decisions or assessments.

- Information is reliable if:

  (a) it can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and therefore reflects the substance of the transactions and other events that have taken place;

  (b) it is free from deliberate or systematic bias and material error and is complete; and

  (c) in its preparation under conditions of uncertainty, a degree of caution has been applied in exercising the necessary judgements.

- Information in financial statements needs to be comparable.
- As an aid to comparability, information in financial statements needs to be prepared and presented in a way that enables users to discern and evaluate similarities in, and differences between, the nature and effects of transactions and other events over time and across different reporting entities.
- Information provided by financial statements needs to be understandable, although information should not be excluded from the financial statements simply because it would not be understood by some users.
- Information is understandable if its significance can be perceived by users that have a reasonable knowledge of business and economic activities and accounting and a willingness to study with reasonable diligence the information provided.
- Information that is material needs to be given in the financial statements and information that is not material need not be given.
- Information is material to the financial statements if its misstatement or omission might reasonably be expected to influence the economic decisions of users, or their assessment of the effectiveness of the stewardship of management.

EXPLANATION

There are few fundamental differences between the principles and explanation relevant to profit-oriented entities, as expressed in Chapter 3 of the Statement, and their interpretation for public benefit entities. Therefore much of what follows is a summary of the discussion in Chapter 3 of the Statement, which should be referred to for a full understanding. Additional explanation specific to public

benefit entities has been added covering going concern, understandability and neutrality and prudence.

RELEVANCE

3.1 Relevance is a general quality that is used as a selection criterion at all stages of the financial reporting process. Information is relevant if it has the ability to influence the economic decisions of users, or their assessment of the effectiveness of the stewardship of management, and is provided in time to influence those decisions.

3.2 Relevant information has predictive or confirmatory value. It has predictive value if it helps users to evaluate or assess past, present or future events. It has confirmatory value if it helps users to confirm or correct their past evaluations or assessments. Maximising the relevance of financial information involves maximising its predictive and confirmatory value.

Going concern

3.3 There are a number of different perspectives from which an entity's financial performance and financial position could be viewed. The perspective that is usually most relevant is based on the assumption that the entity is to continue in operational existence for the foreseeable future. This perspective is commonly referred to as the going concern assumption.

3.4 In determining whether a public benefit entity is a going concern some of the factors, including legal requirements, to be taken into account may vary from those that would be considered in relation to profit-oriented entities. For example, an entity may have tax raising powers that give it the ability to raise revenue as any liabilities fall due, regardless of whether at the time the assessment is undertaken it has sufficient assets to cover its future liabilities.

RELIABILITY

3.5 Information provided by financial statements needs to be reliable. Information is reliable if:

(a) it can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent;

(b) it is free from deliberate or systematic bias (ie it is neutral);

(c) it is free from material error;

(d) it is complete within the bounds of materiality; and

(e) in its preparation under conditions of uncertainty, a degree of caution (ie prudence) has been applied in exercising judgement and making the necessary estimates.

3.6 Faithful representation involves identifying all the rights and obligations arising from the transaction or event, giving greater weight to those that are likely to have a commercial effect in practice, then accounting for and presenting the transaction or other event in a way that reflects that commercial effect – in other words, in a way that reflects its substance.

3.7 The substance of a transaction or other event is not always consistent with that suggested by its legal form. A group or series of transactions that achieves an overall commercial effect will often need to be viewed as a whole in order to be accounted for in accordance with its substance.

3.8 The information provided by financial statements needs to be neutral – in other words, free from deliberate or systematic bias. Financial information is not neutral if it has been selected or presented in such a way as to influence the

making of a decision or judgement in order to achieve a predetermined result or outcome.

COMPARABILITY

3.9 Information in an entity's financial statements gains greatly in usefulness if it can be compared with similar information about the entity for some other period. Information about an entity is also much more useful if it can be compared with similar information about other entities.

Consistency

3.10 Comparability generally implies consistency throughout the reporting entity with each accounting period and from one period to the next. It can also be useful in enhancing comparability between entities, although it should not be confused with the need for absolute uniformity.

Disclosure of accounting policies

3.11 In order to determine whether consistency exists or to assist in making comparisons despite inconsistencies, users need information on accounting policies adopted by entities and of any changes in those policies and the effects of such changes.

UNDERSTANDABILITY

3.12 Information provided by financial statements needs to be understandable and users need to be able to perceive its significance. Whether financial information is understandable will depend on:

(a) the way in which the effects of transactions and other events are characterised, aggregated and classified.

(b) the way in which the information is presented.

(c) the capabilities of users.

3.13 When considering the capabilities of users of the financial statements of public benefit entities, it may not always appear appropriate to assume that they will have a reasonable knowledge of business and economic activities and accounting, for example where the defining class of user is the taxpayer. However, if financial statements are to be useful to a wide range of users for general purposes, the preparers must be able to assume a reasonable knowledge*. In this regard an important role is played by intermediaries, such as oversight and regulatory bodies, who often work on behalf of users such as taxpayers and donors, in assessing the performance of an entity and its management. In these circumstances the capabilities of users might be determined by reference to the expected capabilities of the intermediary. However, the involvement of intermediaries in reviewing financial statements does not negate the need for a public benefit entity to communicate with other users, particularly its funders and financial supporters.

3.14 If there is to be informed public debate on the information provided by financial statements, then the basis on which it is prepared needs to be sound. Financial information will be more understandable to users if it is prepared on a true and fair basis (the concept of true and fair is discussed in the Statement).

MATERIALITY

3.15 Materiality is the final test of what information should be given in a particular set of financial statements. The materiality test asks whether the information content is of such significance as to require inclusion in the financial statements.

3.16 When immaterial information is given in the financial statements the resulting clutter can impair the understandability of the other information provided. In

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* *See also paragraph 3.25.*

such circumstances, the immaterial information will need to be excluded.

3.17 An item of information is material to the financial statements if its misstatement or omission might reasonably be expected to influence the economic decisions of users of those financial statements and their assessments of management's stewardship.

3.18 Whether information is material will depend on the size and nature of the item in question judged in the particular circumstances of the case. The principal factors to be taken into account are set out below. It will usually be a combination of these factors, rather than any one in particular, that will determine materiality.

(a) The item's size is judged in the context both of the financial statements as a whole and of other information available to users.

(b) Consideration is given to the item's nature in relation to:

   (i) the transactions or other events giving rise to it;

   (ii) the legality, sensitivity, normality and potential consequences of the event or transaction;

   (iii) the identity of the parties involved; and

   (iv) the particular headings and disclosures that are affected.

3.19 If there are two or more similar items, the materiality of the items in aggregate as well as of the items individually needs to be considered.

CONSTRAINTS ON THE QUALITATIVE CHARACTERISTICS

3.20 On occasion, a conflict will arise between the characteristics of relevance, reliability, comparability and understandability. In such circumstances, a trade-off needs to be found that still enables the objective of financial statements to be met.

Relevance and reliability

3.21 Where there is a conflict between relevance and reliability, it will usually be appropriate to use the information that is the most relevant of whichever information is reliable.

Neutrality and prudence

3.22 There can also be tensions between two aspects of reliability – neutrality and prudence – as prudence is a potentially biased concept that seeks to ensure that, under conditions of uncertainty, gains and assets are not overstated and losses and liabilities are not understated. Where there is uncertainty, the competing demands are reconciled by finding a balance that ensures that the deliberate and systematic understatement of gains and assets and overstatement of losses do not occur.

3.23 For public benefit entities there can also be tensions leading to the possibility of gains being understated and losses being overstated, for example where a certain level of spending must be achieved or to avoid the presentation of excessive surpluses.

3.24 As a result neutrality must be the uppermost objective.

*Understandability**

3.25 It may not always be possible to present information in a way that can be understood by all users. However,

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* *Understandability is considered in more detail in paragraphs 3.12 to 3.14.*

information that is relevant and reliable should not be excluded because it is too difficult for some users to understand.

CHAPTER 4:

THE ELEMENTS OF FINANCIAL STATEMENTS

Elements of financial statements are the building blocks with which financial statements are constructed – the classes of items that financial statements comprise. This chapter identifies those elements and explains their attributes.

PRINCIPLES

- The elements of the financial statements are:

  (a) assets

  (b) liabilities

  (c) residual interest

  (d) gains

  (e) losses

  (f) contributions establishing a financial interest in the residual interest

  (g) distributions to holders of a financial interest in the residual interest.

- Assets are rights or other access to future economic benefits controlled by an entity as a result of past transactions or events.

- Liabilities are obligations of an entity to transfer economic benefits as a result of past transactions or events.

- Residual interest is the amount found by deducting all of the entity's liabilities from all of the entity's assets*.

- Gains are increases in residual interest not resulting from contributions establishing a financial interest in the residual interest.

- Losses are decreases in residual interest not resulting from distributions to holders of a financial interest in the residual interest.

- Contributions establishing a financial interest in the residual interest are increases in residual interest resulting from transfers from parties that establish a financial interest in that residual interest.

- Distributions to holders of a financial interest in the residual interest are decreases in residual interest resulting from transfers to parties holding a financial interest in that residual interest in their capacity as holders of a financial interest.

EXPLANATION

THE ELEMENTS OF FINANCIAL STATEMENTS

Depicting the effects of transactions and other events

4.1 Financial statements need to reflect, in an appropriate manner, and as far as possible, the effects of transactions and other events on the reporting entity's financial performance and financial position. This involves a high degree of classification and aggregation. Order is imposed on this process by specifying and defining the classes of items – the elements of financial statements – that encapsulate the key aspects of the effects of those transactions and other events.

* *For profit-oriented entities this would be called the ownership interest.*

4.2 The elements of financial statements are:

(a) in the case of the balance sheet (or statement of financial position) – assets, liabilities and residual interest;

(b) in the case of the statement of financial performance – gains and losses;

(c) contributions establishing a financial interest in the residual interest; and

(d) distributions to holders of a financial interest in the residual interest.

Recognition

4.3 The criteria that need to be met before the effects of a transaction or other event on the elements will be recognised are considered in Chapter 5.

ASSETS

Definition

Assets are rights or other access to future economic benefits controlled by an entity as a result of past transactions or events.

Rights or other access

4.4 An asset is not the item of property itself, but rather the rights or other access to some or all of the future economic benefits derived from the item of property*.

4.5 These rights can be obtained in various ways. Often they are obtained by legal ownership of the underlying item of property. However, legal rights to future economic benefit

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* *The term 'item of property' is taken from the Statement. It is used to differentiate between the control of rights or other access to future economic benefits (the asset) and the thing from which those benefits are derived (the item of property).*

derived from an item of property can be obtained without having legal ownership of the property itself, for example, where property is leased.

4.6 Other legal rights that give rise to assets include the right to require other parties to make payments or render services and the right to use a patent or trademark.

Future economic benefits

4.7 Capacity to obtain future economic benefits is the essence of an asset. Therefore, to be an asset, the rights or other access must be capable, singly or in combination with other assets, of yielding economic benefits.

4.8 Many assets held by public benefit entities do not result in direct cash inflows for the entity. The economic benefits that arise from such assets are often in the form of services to the beneficiary or consumer. Furthermore, in many cases, assets are used to provide goods or services to the beneficiary or customer that are free or subsidised. An item can meet the definition of an asset if it is used either directly or indirectly to provide goods and/or services that are used in furtherance of an entity's objectives.

4.9 Therefore although the Statement notes that 'future economic benefits eventually result in net cash inflows to the entity' this may not be the case for public benefit entities, where access to future economic benefits includes:

- an eventual net inflow of cash to the entity; but also
- the provision of goods and/or services to the benefit of the entity's beneficiaries.

4.10 This means that, for public benefit entities, an asset can embody service potential, as well as or instead of cash flows. Service potential is the ability to be utilised to provide expected future goods or services (ie they fulfil a need or

want of the identified customers/beneficiaries) in furtherance of the entity's objectives*.

4.11 In principle all items meeting the definition of an asset should be recognised. These include heritage assets such as:

- Historic assets: which are of acknowledged historic, scientific or artistic importance, the continuing retention, preservation and use of which is in direct furtherance of an entity's objectives.

- Inalienable assets: which the entity is required by law to retain indefinitely for its own use in furtherance of its objectives and which therefore cannot be disposed of without external consent.

4.12 These items meet the definition of assets as they provide future economic benefit; they are used to provide services to the benefit of the entity's beneficiaries. It is possible that even where, for example, such items are not on display, their preservation alone will meet the asset definition.

Controlled by the entity

4.13 The definition of an asset requires that the rights or other access to future economic benefits are controlled by the reporting entity. Control of economic benefits is explained as meaning that the entity must have the ability both to obtain for itself any economic benefits that will arise and to prevent or limit the access of others to those benefits.

4.14 With public benefit entities, the economic benefits that arise from an asset need not flow to the entity itself. As noted above, the assets may instead be used to provide benefits for the beneficiaries of the entity. In the context of such assets,

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* *Measuring the replacement cost of the service potential of an asset is considered in paragraphs 6.11 and 6.12.*

it is therefore the *capacity to provide* future economic benefits that must be controlled by the entity.

4.15 Accordingly, for the purposes of public benefit entities, control of economic benefits is reformulated as follows. An entity will control the rights or other access to future economic benefit if it has the ability:

- both to obtain for itself any economic benefits that will arise and to prevent or limit the access of others to those benefits; or

- to meet its objectives by determining the allocation to beneficiaries of future economic benefits (whether goods or services), including preventing or limiting the access to any future goods or services to be provided.

4.16 Public benefit entities that have custody of an asset may not have all the legal powers of ownership, such as the ability to sell the item. There may also be restrictions on the entity's use of the asset. However, this does not necessarily mean that the entity does not control access to future economic benefits. To satisfy the requirement for control, the entity does not need unlimited power over the physical item. Instead, it is the rights or access to future economic benefit that need to be controlled.

4.17 The requirement that the rights or other access should be controlled by the entity treating them as its asset means that a particular right or other access to future economic benefits will appear in only one set of single entity financial statements, because such rights or access can be directly controlled by only one entity.

4.18 On the other hand, a single item of property may give rise to assets of more than one entity. If two entities control the rights to different future economic benefits from the same item of property, both entities will have an asset (subject to the other aspects of the definition being met).

Past transactions or events

4.19 If the reporting entity's control of the rights or other access to future economic benefits involved is to represent an asset, it needs to be the result of *past* transactions or events.

LIABILITIES

Definition

Liabilities are obligations of an entity to transfer economic benefits as a result of past transactions or events.

Obligations

4.20 For there to be a liability there must be an obligation that might result in the transfer of economic benefits.

4.21 The notion of an obligation implies that the entity is not free to avoid the outflow of economic resources. If an obligation exists, although an entity may offer inducements to its creditors to cancel or postpone settlement, it will not be able to insist that they accept such an offer.

4.22 Although many liabilities are based on legal obligations, a legal obligation is not a *necessary* condition: a liability can exist in the absence of legal obligations if other considerations create a constructive obligation. Particularly in the case of public benefit entities, many commitments to provide public benefits will not give rise to contractual obligations, but may lead to constructive obligations.

4.23 A decision to transfer economic benefit does not, in itself, create a constructive obligation, because the transfer can be avoided by changing the decision. On the other hand, a constructive obligation would be created if such a decision was coupled with an event that both created a valid expectation that the entity involved would implement the decision and meant that the entity could not realistically withdraw from it. For example, a constructive obligation

may be created by communicating a decision to follow a particular course of action to another party. Such an obligation may also be created by an established pattern of past practice.

4.24 An obligation may be apparent from the social or economic consequences of failing to act or perform in the agreed way, which leaves the entity with little, if any, discretion to avoid the transfer of economic benefits. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation caused by the event.

4.25 The existence of a residual interest (see paragraph 4.47), either restricted or unrestricted, that will be utilised in the provision of future benefits to the entity's beneficiaries does not of itself create a liability.

Transfer of economic benefits

4.26 Certainty that the obligation *will* result in a transfer of economic benefits is not necessary. Obligations that are not likely to result in a transfer of economic benefits – such as a guarantee of another entity's debt where that entity is expected to remain solvent – are liabilities even though they may not be recognised in financial statements (or may be recognised with a carrying amount of nil).

4.27 Similarly, although many liabilities involve transfers of known amounts of cash, that need not be the case: a liability could involve an obligation to transfer an uncertain amount, and it could involve an obligation to transfer economic benefits other than cash – for example, by providing services.

4.28 An obligation to make an exchange in the future, which is still equally unperformed by both sides (often called an executory contract) does not usually result in the immediate recognition of a liability. An example is an order to purchase new office furniture: no liability is recognised by the

purchaser until the furniture has been delivered. Various commitments of public benefit entities might be characterised as executory contracts; this is examined in further detail below (see paragraphs 4.36 to 4.41).

Past transactions or events

4.29 For a liability to exist at the balance sheet date, the obligation to transfer economic benefits must have resulted from a *past* transaction or event.

4.30 Sometimes a series of events must take place before the entity will have an obligation to transfer economic benefits. In such circumstances, whether the obligation exists depends on whether any of the events that have still to take place are under the entity's control. If they are, the entity retains discretion to avoid the transfer, so no obligation exists. For example, as long as it is possible to avoid a penalty clause in a contract by performing, a liability in respect of the penalty will not arise.

Commitments to provide public benefits

4.31 Public benefit entities might enter into a number of types of agreements that could lead to potential obligations; public benefits could be delivered via any of these mechanisms.

(a) *General commitments to provide public benefits*. These are general or policy statements of intention, that the entity stands ready to provide goods or services to certain classes of potential beneficiaries in accordance with its objectives (see paragraphs 4.33 to 4.35).

(b) *Specific commitments to provide public benefits*.

(i) *Contracts*. Contracts that would be expected to provide an exchange of goods or services of approximately equal value between a seller and a purchaser.

(ii) *Performance-related grants*. These grants, payable (or receivable) by public benefit entities, have the characteristics of a contract, where for example the grantee provides a service to, or on behalf of, the grantor over a specified period of time and/or a specific amount of grant is receivable per unit of output. Such grants have the substance of contracts and therefore should be accounted for as such (see paragraphs 4.37 to 4.39).

(iii) *Other specific commitments to provide public benefits*. A specific commitment, or promise, to provide specified goods or services to a beneficiary, even though it may be subject to conditions (see paragraphs 4.40 and 4.41). This category would include grants that are not performance-related and is likely to include most benefits provided directly to individuals.

4.32 The types of commitment to provide public benefits described above apply to all public benefit entities, although some entities make more obvious policy statements than others. For example, general commitments ((a) above) would include an intention expressed by a charity to provide grants to general classes of people or entities, which could be articulated in a number of ways, including through the objects of the charity.

General commitments to provide public benefits

4.33 As a principle, these general commitments would not create a liability for the reporting entity because they do not of themselves create an expectation such that the entity cannot withdraw or amend the terms.

4.34 General commitments are expected to include political commitments made by governments, for example the announcement of a forthcoming new initiative to provide cash benefits to members of the public meeting certain

criteria*. Political commitments are different from commercial contracts. Such political commitments (whether express or implied) are political promises; examples are the general promises to provide health-care or education. Governments make and amend such promises and policies as part of their ongoing political processes to manage the economy and redistribute wealth within or between periods and generations. As such they should not be viewed as constructive obligations.

4.35 Where an entity has potential obligations that do not result in the recognition of liabilities it is appropriate to consider whether the disclosure of information relating to these potential obligations should be provided.

Specific commitments to provide public benefits

4.36 The principles underlying the existence of liabilities relating to specific commitments are:

(a) where a specific commitment is one such that the recipient must provide some tangible performance in return from the promised resources, it is in substance an executory contract and therefore does not create a liability when the commitment is made, but depending on the terms of the commitment a liability will arise as performance occurs;

(b) for all other specific commitments, if the promised resources are being provided in furtherance of the entity's objectives then the arrangement is also, in substance, an executory contract where a liability will be recognised usually as the transfer of the resources becomes due.

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* *As noted in the Preface, IPSASB is currently working on the issue of accounting for Social Policies of Governments.*

Therefore, although in theory the possibility of a commitment to provide public benefits giving rise to an immediate liability cannot be ruled out, in practice this is unlikely to happen often since public benefit entities must always operate within their objectives. However, in the event that a commitment to provide public benefits becomes onerous, for example because the reporting entity's objectives will not continue to be met as subsequent payments are made, then a liability would arise.

The paragraphs below examine the two types of specific commitment further.

Performance-related grants

4.37 Performance-related grants are analogous to contracts. Characteristics that might indicate that a grant is performance-related include: a requirement to provide a specific service; and that the payment of grant is conditional on the extent to which a specific output is achieved. Where conditions provide a substantive option for the 'claw-back' of grant where performance levels are not achieved, it should be presumed to be a performance-related grant. An example of a performance-related grant is an agreement to provide a fixed grant per person per meal served in order to finance a meals-on-wheels service for the next five years. Similarly, an agreement to commission a three-year research programme, which adds to the stock of knowledge on a topic, would be considered a performance-related grant, particularly if the grantor was involved in determining the nature and focus of the work and regularly reviews its outcomes.

4.38 To the extent that elements of an agreement are performed, or it becomes onerous, a transfer of economic benefits becomes inevitable and the entity is not free to avoid the outflow of resources and a liability arises. A liability would not usually arise for any other elements of the agreement.

continued...

4.39 It can be difficult to determine whether grants are performance-related or not. For example, a research grant may appear to be non-performance-related because the grantor was not involved in determining the nature and focus of the work, but if the award covers the cost of performing the research, there may be an element of performance as the research takes place, particularly if the terms and conditions required that the grantor would reimburse costs incurred up to the date of termination (should it occur). Then regardless of whether the contract is prematurely terminated a liability arises for the grantor as the relevant costs are incurred by the grantee.

Other specific commitments to provide public benefits

4.40 Where a public benefit entity is providing goods or services to its beneficiaries in pursuance of its objectives (regardless of whether the goods or services are free or subsidised) the obligation to any particular recipient can be thought of as initially, in substance, an executory contract (in which the provision of goods or services by the reporting entity is balanced by the achievement of its objectives). No liability arises in respect of such activity until the stipulated delivery date for the goods and services by the reporting entity, since the achievement of objectives and the provision of goods and services are simultaneous. Often in such circumstances there will be no substantive options for 'claw-back' of the cash or other resources given and therefore no asset will be recognised for their possible return or 'performance' by the recipient, because the reporting entity's objectives will have been met when the cash or other resources were given.

4.41 As noted above, for a performance-related grant the 'performance' is likely to be measured by the achievement of specific outputs. Many non-performance-related grants may be simply enabling the grantee to carry out its own work.

4.42 There may be circumstances in which a reporting entity is acting as an agent for another entity, where, for example cash has been received by the entity to be passed on to persons meeting certain specific criteria specified by the

other entity. Depending on the nature of the arrangement it is possible that a liability should be recognised to match the receipt of the cash prior to its dispersal. Such a liability would represent an obligation to the entity providing the cash, not to the ultimate recipient.

OFFSETTING RIGHTS AND OBLIGATIONS

4.43 When a transaction or other event gives rise to a number of rights and obligations, it is necessary to consider whether some or all of those rights and obligations need to be offset either with each other or with rights and obligations that arise from other transactions or events.

4.44 If a right to receive future economic benefits and an obligation to transfer future economic benefits exist and the reporting entity has the ability – which is assured – to insist on net settlement of the balances, the right and obligation together form a single asset or liability regardless of how the parties intend to settle the balances.

4.45 When an entity enters into an agreement with another, it usually obtains certain rights and, in exchange, accepts certain obligations. Before any act of performance under the agreement has taken place, the entity does not have control of the future economic benefits arising from performance, nor does it have an obligation to transfer economic benefits that arise on performance. What it *does* have, however, is a contract that represents a net position comprising a combined right and obligation either to participate in the exchange or alternatively to be compensated (or to compensate) for the consequences of the exchange not taking place. Initially, the rights and obligations are likely to be exactly offsetting, although that will often not remain the case. The rights and obligations arising under such unperformed executory contracts together represent a single asset or liability. Consistently with the discussion of restrictions in Chapter 5, the receipt of resources with restrictions attached does not usually delay their recognition as an asset and a gain.

4.46 It may be that the contract has been performed partially but is equally proportionately unperformed – in other words, that both parties to the contract have still to perform to an equal degree the actions promised by and required of them under the contract. In such a case, although the rights and obligations relating to the performed part of the contract may represent separate assets and liabilities, the rights and obligations relating to the unperformed part will together represent a single asset or liability.

RESIDUAL INTEREST

4.47 Residual interest is defined as follows:

Residual interest is the amount found by deducting all of the entity's liabilities from all of the entity's assets.

4.48 As such the residual interest, being derived from the assets and liabilities arising from past events, will be determined at each reporting date.

4.49 The Statement addresses the residual interest in relation to profit-oriented entities and notes that owners invest in an entity in the hope of a return, for example the payment of dividends. Most public benefit entities do not have owners, and where there are owners, they will not usually have rights to participate in a distribution in excess of the nominal value of their ownership instrument (ie they usually hold non-equity interests). Therefore the residual interest should not be attributed to any individual, entity or group of individuals or entities, including owners where they exist*. Where, in the event of a winding up the ultimate residual interest would be required to be distributed in a particular way, that fact should be disclosed.

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* *Even where owners may have a limited right to participate, because of the limitations it would not be appropriate to attribute the entire residual interest to the owners.*

4.50 The distinction between liabilities and residual interest is highly significant. Creditors have the ability to insist that a transfer of economic benefit is made to them regardless of the circumstances. In contrast the residual interest represents resources that the entity retains for the provision of future benefits. In certain forms of entity, these resources may be held under trust, either to be retained for the generation of future income, or to be spent on particular restricted purposes. The nature of the residual interest should be clear from disclosure in the financial statements.

4.51 Where, for example, restricted funds exist, there may be more than one class of residual interest. The existence of different classes of residual interests requires disclosure within the financial statements.

4.52 The mere designation of a portion of the residual interest as being set aside, reflecting no more than past expenditure or future intentions, does not create a different class of residual interest and does not lead to the recognition of a transaction in the financial statements. However, such information would be properly included in accompanying information (see paragraphs 7.15 to 7.18).

GAINS AND LOSSES

Definitions

Gains are increases in residual interest not resulting from contributions establishing a financial interest in the residual interest.

Losses are decreases in residual interest not resulting from distributions to holders of a financial interest in the residual interest.

4.53 The terms 'gains' and 'losses' therefore include items that are often referred to as 'revenue' or 'income' and 'expenses'.

4.54 Chapter 5 provides guidance on the recognition process for transactions and events that have an effect on the financial statements. If neither a transaction nor an event has occurred there will be no changes in the reporting entity's assets and liabilities and consequently no gain or loss to recognise.

4.55 For some public benefit entities events occur that involve the receipt of goods* or services that have been voluntarily given. The occurrence of such an event does not necessarily result in the recognition or derecognition of items in the financial statements; this will depend on the effect it has on the assets and liabilities of the reporting entity.

4.56 Where a voluntary gift involves the receipt of goods (for example cash, works of art or furniture) the event should be recognised based on the current value to the recipient (measures of current value are discussed in Chapter 6), provided it can be measured with sufficient reliability and taking into account its expected utility to the recipient, including any restrictions placed on its use by the donor.

4.57 In contrast other voluntary gifts involve the receipt of services that are immediately consumed (for example volunteers' time, free occupation of premises and free professional services); these are events that potentially have an economic effect on the reporting entity. In principle, where an event has an economic impact on a reporting entity it should be reflected in the financial statements, but in practice other factors may sometimes prevent this.

4.58 In particular, events should not be recognised in the financial statements if it is not possible to measure their impact with sufficient reliability. The economic value of some gifts of services will be difficult to measure (other than at an arbitrary amount), for example, volunteers' time. Therefore the proposed Interpretation proposes that only

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* *For this purpose 'goods' includes cash and financial instruments.*

those services meeting certain criteria should be recognised in the financial statements.

4.59 For voluntary services a distinction can be drawn between those services that, if not received voluntarily, would have been purchased and those that would not. It would be expected that services that would otherwise have been purchased should be recognised in the financial statements based on the estimated value to the recipient, provided they can be reliably measured. Services that would otherwise have been purchased would often be those which the provider (either an individual or an entity) would ordinarily carry out in the normal course of their usual profession or trade, and for which they would ordinarily charge a fee commensurate to the services provided. Where voluntary services are recognised in the financial statements it would be as income and, usually, expenditure of an equal amount.

4.60 Where voluntarily received services are not recognised in the financial statements and it is necessary in order to gain a better understanding of the activities of a reporting entity, disclosure of the nature of the event(s) should be provided, if practicable.

CONTRIBUTIONS ESTABLISHING A FINANCIAL INTEREST IN THE RESIDUAL INTEREST

Definition

Contributions establishing a financial interest in the residual interest (capital contributions*) are increases in residual interest resulting from transfers from parties that establish a financial interest in that residual interest.

4.61 Capital contributions include only those transactions that establish a financial interest in the residual interest. Transactions with the same parties that are not entered

* *Here 'capital contribution' does not necessarily refer to the gift of an endowment.*

into in this capacity (for example those as customers, beneficiaries, donors or suppliers) result in gains and losses.

4.62 A financial interest in the residual interest is one that conveys a right to participate in the residual interest (either on an ongoing basis or in a winding up).

4.63 Capital contributions involve parties making a contribution of economic benefits (which may, for example, be in the form of cash or assets providing service potential) to the entity. In practice for public benefit entities, although capital contributions establish a financial interest in the net assets of the entity, it may be that the contribution sometimes has the effect of reducing the level of a potential future deficit to be met in the event of the entity being wound up.

4.64 Some public benefit entities have a controlling party* (for example as a result of powers to appoint the members of its governing body), although the controlling party may not be a legal "owner" of the reporting entity. Contributions from a controlling party may or may not include capital contributions. However, due to the nature of the relationship between an entity and its controlling party the impact on the financial performance and financial position of a public benefit entity of any resources received that are not capital contributions should be clear.

DISTRIBUTIONS TO HOLDERS OF A FINANICAL INTEREST IN THE RESIDUAL INTEREST

Definition

Distributions to holders of a financial interest in the residual interest (capital distributions) are decreases in residual interest resulting from transfers to parties holding a

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* *Consistently with Chapter 2 a controlling party is an individual or entity that has control of a second entity.*

financial interest in that residual interest in their capacity as holders of a financial interest.

4.65 The Statement includes "distributions to owners" as one of the elements of the financial statements. As noted above most public benefit entities do not have owners, and those that do are often unable to make distributions (for example, it may be prohibited by the governing instrument), therefore capital distributions are not likely to be common.

4.66 Capital distributions include the payment of dividends and the return of capital. Where public benefit entities make capital distributions achieving this financial return would not be their primary objective.

CHAPTER 5:

RECOGNITION IN FINANCIAL STATEMENTS

When the reporting entity undertakes a transaction or when some other relevant event occurs, the effect of that transaction or event on the elements of financial statements will need to be recognised in the financial statements if certain criteria are met. This chapter considers that recognition process.

PRINCIPLES

- If a transaction or other event has created a new asset or liability or added to an existing asset or liability, that effect will be recognised if:

  (a) sufficient evidence exists that the new asset or liability has been created or that there has been an addition to an existing asset or liability; and

  (b) the new asset or liability or the addition to the existing asset or liability can be measured at a monetary amount with sufficient reliability.

- In a transaction involving the provision of goods or services for a net gain, the recognition criteria described above will be met on the occurrence of the critical event in the operating cycle involved.

- In a transaction involving the receipt of resources other than for the provision of goods or services for a net gain the recognition criteria described above will often be met when there is clear evidence of a right to receive the resources.

- An asset or liability will be wholly or partly derecognised if:

(a) sufficient evidence exists that a transaction or other past event has eliminated all or part of a previously recognised asset or liability; or

(b) although the item continues to be an asset or a liability, the criteria for recognition are no longer met.

EXPLANATION

Other than in relation to revenue recognition there are few fundamental differences between the principles and explanation relevant to profit-oriented entities, as expressed in Chapter 5 of the Statement, and their interpretation for public benefit entities. Therefore much of what follows is a summary of the discussion in Chapter 5 of the Statement, which should be referred to for a full understanding. Additional explanation specific to public benefit entities has been added covering historic and inalienable assets and the various aspects of revenue recognition.

THE RECOGNITION PROCESS

The stages of the recognition process

5.1 The objective of financial statements is achieved to a large extent through the recognition of elements in the primary financial statements - in other words, the depiction of elements both in words and by monetary amounts and the inclusion of those amounts in the primary financial statement totals. This recognition process has the following stages:

(a) initial recognition, which is where an item is depicted in the primary financial statements for the first time;

(b) subsequent remeasurement, which involves changing the amount at which an already recognised asset or liability is stated in the primary financial statements; and

(c) derecognition, which is where an item that was until then recognised ceases to be recognised.

Transactions and events other than transactions

5.2 The recognition process requires that all events that may have an effect on elements of the financial statements are, as far as is possible, identified and reflected in an appropriate manner in the financial statements.

5.3 Transactions are the most common form of such events and are therefore the most common reason for recognising and derecognising items. Events other than transactions may nevertheless also result in the recognition or derecognition of items. For example, events such as discovery may result in the creation of new assets that may meet the recognition criteria. Events (such as a fire) that cause damage to an asset may result in a need to derecognise the asset or liability involved.

The effect of transactions and other events

5.4 The starting point for the recognition process is the effect that the transaction or other event involved has had on the reporting entity's assets and liabilities. The interrelationship between the elements means that the recognition of one item as an element will inevitably result in the recognition of, or change in, another element. Thus, if a new asset is recognised, there will also be recognised a decrease in another asset, a new or increased liability, a gain, or a contribution from owners (or a combination of these).

5.5 A transaction or other event could have one of several effects on a reporting entity's assets and liabilities.

(a) It might create a new asset or liability or add to an existing asset or liability. When this is the case, it will be necessary to determine whether the new asset or liability (or the addition thereto) should be recognised, because not all assets and liabilities are recognised.

(b) It might provide additional evidence about an existing but unrecognised asset or liability and, as a result, enable that item to be recognised.

(c) It might change some aspect of an already recognised asset or liability.

(d) It might involve transferring, using up or consuming an asset or settling, extinguishing or transferring a liability. On the other hand, it might leave intact certain of the rights to future economic benefits inherent in an asset whilst transferring, using up or consuming others, or it might leave intact certain obligations inherent in a liability whilst settling, extinguishing or transferring others.

5.6 The non-cash effects of transactions and other events should, as far as is possible, be reflected in the financial statements in the accounting period in which they occur and not, for example, in the period in which any cash involved is received or paid. This is commonly referred to as the 'accruals concept'.

Uncertainty and the recognition process

5.7 Entities operate in an uncertain environment and this uncertainty may sometimes make it necessary to delay the recognition process.

5.8 If uncertainty exists, totally reliable information will become available only when the uncertainty has resolved itself. However, to defer recognition until the uncertainty has resolved itself will often reduce the relevance of the financial statements. It may also reduce their reliability because they will not represent faithfully the transactions and other events of the reporting period. Financial statements achieve a balance between these competing demands by seeking to provide information that has no more than an acceptable degree of uncertainty but not seeking to provide information that is totally free from uncertainty.

5.9 There may be circumstances in which it is not possible to reduce the uncertainty to an acceptable level. If that is the case, the recognition process will be deferred until such time as the uncertainty has been reduced to an acceptable level (and the effect of the transaction or other event will instead usually be reported in the notes to the financial statements).

INITIAL RECOGNITION

Categories of uncertainty

5.10 In the initial recognition process, there are two broad categories of uncertainty that could arise:

(a) element uncertainty, which involves uncertainty whether an item exists and meets the definitions of the elements of financial statements; and

(b) measurement uncertainty, which concerns the appropriate monetary amount at which to recognise the item.

Element uncertainty

5.11 Element uncertainty is countered by evidence – the more evidence there is about an item and the better the quality of that evidence, the less uncertainty there will be over the item's existence and nature. To recognise an item it is necessary to have sufficient evidence, both in amount and quality, that the item exists and is an asset or liability of the reporting entity. One of the criteria for initial recognition is that sufficient evidence must exist that a new asset or liability has been created.

5.12 What constitutes sufficient evidence is a matter of judgement, although while the evidence needs to be adequate, it need not be (and often cannot be) conclusive. The main source of evidence will be past or present experience with the item itself or with similar items.

Measurement uncertainty

5.13 To recognise an item, it is necessary to attribute a monetary amount to it. This involves two steps: selecting a suitable measurement basis (ie historical cost or current value) for the item and determining an appropriate monetary amount for the basis chosen.

5.14 Uncertainty about the appropriate monetary amount at which to recognise the item (in other words, measurement uncertainty) is reflected in the second of the criteria for initial recognition, which requires that the new asset or liability or addition to an existing asset or liability can be measured at a monetary amount with sufficient reliability.

5.15 The purchase or receipt of an asset should be measured and included in the financial statements, provided it can be measured reliably. Thus where an historic or inalienable asset* is received, it should, in principle, be reflected in the financial statements. In some cases sufficiently reliable information may not exist, but for assets that are newly acquired, reliable measurement information is likely to be available.

Prudence

5.16 The exercise of prudence does not justify the omission of assets or gains when there is sufficient evidence of occurrence and reliability of measurement or the inclusion of liabilities or losses when there is not. Nor does it justify any other deliberate and systematic overstatement of liabilities or losses or deliberate and systematic understatement of assets or gains.

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* *See also paragraph 4.12.*

Unperformed contracts

5.17 When an entity enters into an agreement with another party, it obtains certain rights and, in exchange, accepts certain obligations. Before any act of performance under the agreement has taken place, the entity will have only a net position comprising a combined right and obligation either to participate in the exchange or alternatively to be compensated (or to compensate) for the consequences of the exchange not taking place. Although this right and the obligation will usually be in balance initially, changing circumstances may cause an imbalance to arise, in which case the net position will be either an asset or a liability. This asset or liability will be recognised if the recognition criteria are met (and if the amount at which the asset or liability is to be measured is not nil).

DERECOGNITION

Derecognition because the asset or liability has been eliminated

5.18 Assets tend, in due course, to be consumed, transferred or otherwise disposed of, or they expire. Similarly, liabilities tend to be settled, extinguished, transferred, or they expire. In such circumstances, it may be necessary to derecognise some or all of the asset or liability involved.

5.19 It is usually relatively simple to determine whether and when a previously recognised asset or liability needs to be derecognised. However, some transactions leave intact certain of the rights to future benefits inherent in an asset (or obligations inherent in a liability) while eliminating others. In such circumstances, analysis is required to ascertain whether the effect of the transaction should be reflected by derecognising some or all of the assets and liabilities involved.

5.20 Ideally, an asset or liability would be derecognised as soon as it has been eliminated. However, there will sometimes be

uncertainty about an item's continued existence. In such circumstances, derecognition will not take place until sufficient evidence exists that the transaction or other event has resulted in the elimination of the item. When there is uncertainty, prudence usually requires more confirmatory evidence about the existence of, and a greater reliability of measurement for, assets than is required for liabilities. This tends to mean that, if there is any significant uncertainty about an asset's continued existence, it will be derecognised. However, in the case of a liability, more evidence of its elimination will be needed before it will be derecognised.

Derecognition because the criteria for recognition are no longer met

5.21 It is possible that although there has been no significant change in the inherent nature of an already recognised asset or liability - in other words, although the asset or liability has not been eliminated - the criteria for recognition are no longer met. For example, an event may have created additional uncertainty and, as a result, a previously recognised asset or liability can no longer be measured with sufficient reliability. On the rare occasions when this is the case, that asset or liability will be derecognised even though it has not been eliminated.

REVENUE RECOGNITION

5.22 Assuming that no capital contribution is involved:

(a) if the effect of a transaction or other event is to increase the entity's recognised net assets, a gain will be recognised.

(b) a loss will be recognised if, and to the extent that, previously recognised assets have been reduced or eliminated or cease to qualify for recognition as assets without a commensurate increase in other assets or reduction in liabilities. Similarly, a loss will be

recognised when, and to the extent, that a liability is incurred or increased without a commensurate increase in recognised assets or a reduction in other liabilities.

5.23 However, although the starting point for the recognition process may be the effect on assets and liabilities, the notions of matching and the critical event in the operating cycle will often help in identifying these effects.

Matching

5.24 Matching has two forms.

(a) Time matching involves the recognition of receipts (and payments) directly associated with the passage of time as gains (and losses) on a systematic basis over the course of the period involved.

(b) Revenue/expenditure matching involves the recognition of expenditure directly associated with the generation of specific gains as a loss in the same period as the gains are recognised, rather than in the period in which the expenditure is incurred.

5.25 Almost all expenditure is undertaken with a view to acquiring some form of benefit in exchange. Consequently, if matching were used in an unrestricted way, it would be possible to delay the recognition in the performance statement of most items of expenditure insofar as the hoped-for benefits still lay in the future. The Statement imposes a degree of discipline on this process because only items that meet the definitions of, and relevant recognition criteria for, assets, liabilities or ownership interest (or residual interest for public benefit entities) are recognised in the balance sheet. This means that the Statement does not use the notion of matching as the main driver of the recognition process.

Critical event in the operating cycle

5.26 Sometimes it is easier to identify the appropriate point at which to recognise gains arising from the provision of services or goods - and therefore changes to the entity's assets and liabilities - by focusing on the operating cycle of the reporting entity and, in particular, on the critical event in that cycle.

5.27 The critical event is the point in an operating cycle at which there will usually be sufficient evidence that the gain exists and it will usually be possible to measure that gain with sufficient reliability.

5.28 For many types of transaction, the critical event in the operating cycle is synonymous with full performance. In such cases a gain will be recognised when the entity providing the service or goods has fully performed. That need not, however, be the case: the critical event could occur at other times in the cycle and there could be more than one critical event in the cycle.

5.29 The identity of the critical event or events of an operating cycle will depend on the particular circumstances involved. For certain public benefit entities the concept of the critical event has direct application to revenue arising from fees and charges and performance-related grants*. However, for other sources of revenue, such as taxation and donations, gains may occur that are unrelated to the provision of specific goods or services. There may, therefore, not be a need to look for a critical event in the operating cycle as part of the recognition process. Instead, the focus will be on whether an asset exists and whether or not it has led to a corresponding liability. As such the recognition criteria are likely to be met when the recipient has a right to receive the

* *'Performance-related grants' is used in this context to refer to a grant that has the appearance of a contract, where a specified amount of grant is receivable for a specific output.*

resources (in some cases this will not be prior to actual receipt of the resources).

Should all gains be treated as revenue?

5.30 Fees and charges and performance-related grants that arise as a result of a critical event in the operating cycle of the entity should be classified as revenue. In this context revenue should be taken to mean "turnover", or the revenue arising from the operating activities of the reporting entity.

5.31 Gains* that arise, for example from the raising of taxes, or through an appropriation or grant-in-aid, or donations, should also be classified as revenue, and be recognised when there is sufficient evidence that a gain exists and it can be measured with sufficient reliability.

5.32 Other gains, such as those arising from the sale of fixed assets do not normally give rise to revenue.

Grants for financing capital projects

5.33 Some public benefit entities receive donations or grants intended to finance capital projects, such as the acquisition or construction of a fixed asset. The receipt, by public benefit entities, of grants or donations for financing capital projects often reflects the fact that the asset will be used to provide goods or services that are free of charge, or substantially subsidised at the point of receipt. Providing a subsidy for an asset that provides a service can be an alternative to an ongoing commitment to subsidise the 'revenue' costs of providing the service. As such the difference between the two approaches could simply be the timing of the grant cash flows.

* *In accordance with the definition, gains exclude capital contributions.*

5.34 The receipt of the grant or donation does not reduce the cost of the asset itself*, nor is it a contribution to equity. Therefore:

(a) where all conditions attaching to the receipt of the resources have been met the grant or donation should be accounted for as revenue;

(b) where grants or donations are received subject to conditions†, which have not been met, they should be reported as liabilities until such time as the conditions within the entity's control have been substantially met‡;

(c) where donations are receivable subject to legal restrictions over their ongoing use, this does not prevent recognition as revenue providing all other conditions are met, but additional disclosure may be required to reflect the nature of the resources.

5.35 One common condition of capital grants to public benefit entities is that the grant must be repaid in the event of the recipient subsequently selling the asset it was used to purchase. Assuming that a decision on the sale of the asset is within the reporting entity's control, if this is the only outstanding condition then the grant should be recognised in full as a gain. This is because the possibility of repayment of the grant can be avoided by deciding not to sell the asset.

5.36 An asset that has been wholly or partly financed by a capital grant should be subject to an impairment review on completion (if constructed) or acquisition (if purchased) to ensure that the gross cost of the asset is not greater than its

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* *Although the net cost to the acquirer has been reduced.*

† *A further discussion of the impact of conditions is provided at paragraphs 5.38 to 5.45.*

‡ *For the conditions to have been substantially met it is implied that any outstanding conditions are trivial.*

recoverable amount*. It is possible that for some assets, particularly those used to generate cash inflows, that the gross cost of construction or acquisition will be greater than the recoverable amount and therefore an impairment should be recognised.

5.37 Some preparers may consider that by reflecting the capital grant or donation as revenue received in full, when it is being used to finance the purchase of an asset that will be utilised over a number of years, the accumulated revenue position of the entity may be misunderstood by some users. This could be addressed by including explanatory material in the information accompanying the financial statements.

Conditions and restrictions attached to grants and donations

5.38 Public benefit entities often receive grants or donations with conditions or restrictions attached (these might also be termed stipulations). For example a charity might receive a donation of an item of property, together with an endowment fund, where the donor specifies that the property must be maintained to at least its current condition and opened to the public, and where the income from the fund must be used only to finance the maintenance of the property; these would usually be considered restrictions. Alternatively a further education college might receive a grant on condition that it provides a particular course and a minimum number of students complete the course; these would usually be considered conditions.

5.39 There are differences between conditions and restrictions. Restrictions limit the use that may be made of the resources in the future. Conditions must be fulfilled before the entity takes unconditional control of the resources. The existence of restrictions does not impact on the initial recognition of

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* *Chapter 6 provides guidance on measuring the value in use of the assets of public benefit entities, which can include an assessment of the replacement cost of the service potential of the asset.*

the resources (unless the restrictions are so severe that it is determined that the reporting entity does not control the resources) as revenue. The existence of conditions might indicate that the receipt of the resources should result in the recognition of a liability until the conditions have been met.

5.40 Conditions are usually attached to grants (this does not necessarily mean that most grants are conditional). The fulfilment of the conditions may be within the reporting entity's control or outside the reporting entity's control. Using the further education college course example from above, it is within the college's control to decide whether to run the course in the first place whereas it is, at least partly, outside the college's control whether the requisite number of students enrol and complete the course.

5.41 Where the conditions are within the reporting entity's control and it is virtually certain that the conditions will be met, the resources should be recognised as a gain. Where it is not virtually certain that conditions within the reporting entity's control will be met, any resources received in advance should be recognised as a liability until such time as it becomes virtually certain that they will be met. For example if the only condition attached to a grant is that the recipient must provide a copy of its annual report to the grantor, it would be appropriate to recognise the grant as a gain on receipt.

5.42 In some cases the conditions of the agreement are such that it amounts to a performance-related grant, where gains should usually be recognised as performance is delivered.

5.43 In other cases, prior to it being virtually certain that all conditions within the entity's control will be met, it may be possible that meeting certain of the conditions results in unconditional entitlement to a proportion of a grant, that proportion should be recognised as a gain at that time.

5.44 Public benefit entities may also need to be mindful that under certain grant agreements they may be acting as an agent for another party.

5.45 Where the fulfilment of the conditions is substantially outside the control of the reporting entity any resources received in advance should be recognised as a liability until such time as the conditions are met.

CHAPTER 6:

MEASUREMENT IN FINANCIAL STATEMENTS

Measuring an asset or liability entails deciding on the measurement basis to be used and determining the monetary amount that is appropriate for that basis. It may also involve revising the monetary amount when certain events occur. This chapter describes the measurement process and explains how a choice is made between the measurement bases available.

PRINCIPLES

- In drawing up financial statements, a measurement basis - either historical cost or current value - needs to be selected for each category of assets or liabilities. The basis selected will be the one that best meets the objective of financial statements and the demands of the qualitative characteristics of financial information, bearing in mind the nature of the assets or liabilities concerned and the circumstances involved.

- An asset or liability being measured using the historical cost basis is recognised initially at transaction cost. An asset or liability being measured using the current value basis is recognised initially at its current value at the time it was acquired or assumed.

- Subsequent remeasurement will occur if it is necessary to ensure that:

  (a) assets measured at historical cost are carried at the lower of cost and recoverable amount;

  (b) monetary items denominated in foreign currency are carried at amounts based on up-to-date exchange rates; and

(c) assets and liabilities measured on the current value basis are carried at up-to-date current values.

- Such remeasurements, however, will be recognised only if:

(a) there is sufficient evidence that the monetary amount of the asset or liability has changed; and

(b) the new amount of the asset or liability can be measured with sufficient reliability.

EXPLANATION

There are few fundamental differences between the principles and explanation relevant to profit-oriented entities, as expressed in Chapter 6 of the Statement, and their interpretation for public benefit entities. Therefore much of what follows is a summary of the discussion in Chapter 6 of the Statement, which should be referred to for a full understanding. Additional explanation specific to public benefit entities has been added covering alternative measures of current value.

ALTERNATIVE BASES OF MEASUREMENT

6.1 Assets and liabilities have several different monetary attributes that could be represented in financial statements. The single most important characteristic that distinguishes these monetary attributes (which are known as measurement bases) is whether they are based on historical cost or current value. This chapter concentrates on that distinction.

6.2 The mixed measurement system permits the measurement basis to be selected separately for each category of assets or liabilities. It also permits the use of historical cost (or current value) for all assets and liabilities if historical cost (or current value) is the most appropriate measure for each of those categories. Thus it can be adapted to fit the particular circumstances involved.

6.3 The Statement therefore envisages that the mixed measurement system will be used and it focuses on the mix of historical cost and current value to be adopted.

ALTERNATIVE MEASURES OF CURRENT VALUE

6.4 The current value of an asset could be determined by reference to entry value (replacement cost), exit value (net realisable value) or value in use (discounted present value of the cash flows expected from continuing use and ultimate sale by the present owner). For some assets, for example fixed assets specific to the entity's activities, differences between the alternative measures can be material.

Value in use

6.5 Most fixed assets controlled by a public benefit entity will be employed in the provision of goods or services to its beneficiaries in furtherance of its objectives. In some circumstances a recipient may also have contributed indirectly towards the cost of the provision of the goods or services (for example, council tax receipts might be used to subsidise the cost of renting videos from the library), but the public benefit entity may or may not make a direct charge for the provision of such goods and services.

6.6 Where goods and services are not provided free of charge the recipient will purchase them:

(a) at a market rate;

(b) at a partially subsidised rate (being below the market rate, but for these purposes it represents at least a break-even position);

(c) for a nominal rate.

6.7 For those assets held by public benefit entities that are utilised in providing goods/services free of charge or for a nominal rate, it is not possible to compute a realistic value in

use, because the cash inflows do not represent the value derived from the use of the asset. For these assets the value in use of the asset should be replaced by the replacement cost of the service potential of the asset (which is described in 6.11 and takes account of the possibility of impairment).

6.8 Where assets generate significant cash flows based on a market, or partially subsidised rate, value in use can be computed using a cash flow model.

Selection of a measure of current value

6.9 It is necessary to select from these alternative measures of current value the measure that maximises the relevance of the current value basis. Current value is at its most relevant when it reflects the loss that the entity would suffer if it were deprived of the asset involved. That measure, which is often referred to as the 'deprival value' or the 'value to the business', will depend on the circumstances involved.

(a) In most cases, the public benefit entity will be fully using the asset in order to further its objectives and therefore the entity will, if deprived of the asset, replace it, and the current value of the asset will be its current replacement cost. For those assets in categories (a) and (b) (see paragraph 6.6 above) this is because the asset's value in use (in other words, its recoverable amount) will exceed, or equal, its replacement cost*. For those assets in category (c) (see paragraph 6.6 above), or where services are provided free of charge, it will be the replacement cost of the service potential of the asset.

(b) An asset will not be replaced if the cost of replacing it exceeds its recoverable amount. In such circumstances, the asset's current value is that recoverable amount.

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* *Unless the receipt of a capital grant has resulted in the recognition of an impairment.*

(i) When the entity would further its objectives to a greater extent by selling the asset, the asset's recoverable amount will be the amount that can be obtained by selling it, net of selling expenses; in other words, its net realisable value.

(ii) When the entity would further its objectives to a greater extent by consuming the asset - for example by continuing to operate it - its recoverable amount will be its value in use (or, for assets in category (c) (see paragraph 6.6 above), the cost of replacing its service potential*).

6.10 Many public benefit entities have assets that are specialised in nature, where there may be no viable market for the asset's sale. As a result assets are infrequently valued on the basis of net realisable value because it is often artificially low as a result of the lack of an active market.

Measuring the replacement cost of the service potential of an asset

6.11 Service potential was defined in paragraph 4.10. The definition requires there to be an expected demand for the goods or services the asset is to be used to provide. As such in measuring the replacement cost of the service potential of an asset reference must be made to the expected utilisation of the asset not its theoretical maximum capacity. Therefore, to the extent that an item is not expected, over its useful economic life, to reach its originally assessed standard of performance, it is likely to have suffered an impairment (subject to a comparison to net realisable value). For example, if a hostel had been constructed to provide accommodation for fifty people, the fact that a commercial market rent would not be obtained would not necessarily lead to an impairment. However, if at some point it became clear that, because of changes in demographics, the hostel

* *Where, for example, an asset is not fully utilised, the replacement cost of the service potential will be less than the replacement cost of the asset as a whole.*

would in the future provide accommodation for no more than thirty people, then the standard of performance of the property has diminished and it may have suffered an impairment

6.12 Similarly since current value is supposed to represent the loss the entity would suffer if it were deprived of an asset, consideration needs to be given to the most efficient method of obtaining equivalent services to those derived from using the asset. If, for example, it is considered that the most efficient method, at present, would be to engage an external contractor rather than obtaining the services directly by using the asset owned by the reporting entity, then where reasonable evidence of the possibility of alternative arrangements is available, the asset's current value will be the higher of its net realisable value and the present value of the cash flows that would be incurred in obtaining equivalent services from the external contractor.

Current value of liabilities

6.13 It is possible to select a current value for a liability in a similar manner to the 'deprival value' or 'value to the business' method used for assets (using the concept of 'relief value'). The relief value of a liability is the lowest amount at which the entity could divest itself of the obligation involved - in other words, the lowest amount at which the liability could, hypothetically, be settled*.

THE MEASUREMENT PROCESS

6.14 It is not the function of financial statements to represent directly the total value that the reporting entity would fetch in an exchange transaction. Instead, the financial statements provide information designed to assist users to make

* *In October 2002 the ASB published "Liabilities and how to account for them: an exploratory essay", which suggests that this definition could be expanded to be the higher of consideration and settlement amount (being the lower of the cost of performance and the cost of release).*

judgements about the entity's financial performance and financial position. The purpose of the measurement process is therefore to measure the effects of the transactions and events of the period on the financial performance and financial position of the entity.

Initial recognition

6.15 An asset or liability that is being measured using the historical cost basis will be recognised initially at transaction cost or, if an event other than a transaction is involved, at its fair value at the time it was acquired or assumed.

6.16 An asset or liability that is being measured using the current value basis will be recognised initially at its current value at the time it was acquired or assumed.

6.17 This means that, regardless of the measurement basis used, assets and liabilities that arise from transactions carried out at fair value - which is the vast majority of assets and liabilities - will be measured on initial recognition at their transaction cost. That is because, in the case of such a transaction, the fair value of the consideration paid or received (ie the transaction cost) is equal to the current value of the asset or liability at the time of acquisition.

6.18 It can generally be assumed that, in the absence of evidence to the contrary, a transaction has been carried out at fair value. In such circumstances, the transaction cost involved can be determined by reference to the fair value of either the asset (or liability) acquired or the consideration paid (or received); whichever fair value is easiest to measure will usually be used.

6.19 If an asset or liability arises from a transaction that was not carried out at fair value, it will often be more appropriate to measure the asset or liability at current value rather than historical cost. For example, an asset might be received as a gift or donation, in which case it should be recognised at its current value to the entity on the date it is received. As

discussed in paragraphs 6.9 and 6.11 above the current value is likely to be the replacement cost of the service potential of the asset, which will reflect its expected utilisation.

Subsequent remeasurement

6.20 If a pure historical cost measurement basis is being used, the carrying amount of an asset or liability will always be the amount at which it was initially recognised; in other words, there is no subsequent remeasurement stage. The carrying amount of an asset or liability measured at historical cost may nevertheless need to be changed so that the item remains at cost. For example, in the case of assets that are consumed over more than one accounting period (such as fixed assets), the amount at which the asset was recognised initially will be reduced over the expected life of the asset so as to allocate the asset's cost over its expected life. These adjustments are not remeasurements; they are adjustments to maintain the carrying amount at an amount based on historical cost.

6.21 In practice, however, this 'pure historical cost basis' is rarely used. Instead, to make historical cost more relevant to the needs of users, a variation is used that involves a limited amount of remeasurement. The purpose of this remeasurement is to ensure that:

(a) assets are not reported at amounts greater than their recoverable amount*; and

(b) monetary assets and liabilities denominated in currencies other than the reporting currency are stated at an amount that is based on up-to-date exchange rates.

6.22 When the current value basis of measurement is being used, remeasurement takes place to ensure that the assets or liabilities involved are measured at an up-to-date current

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* *Recoverable amount might be determined by reference to the asset's service potential.*

value. Such remeasurements will, however, be recognised in the financial statements only if:

(a) there is sufficient evidence that the amount of the asset or liability has changed; and

(b) the new amount of the asset or liability is capable of being measured with sufficient reliability.

6.23 What constitutes sufficient evidence is a matter of judgement in the particular circumstances, although whilst the evidence will need to be adequate, it need not be conclusive. Relevant considerations will include its persuasiveness and whether the change implies that a gain or loss has occurred.

6.24 The issues to be considered in deciding whether the new amount of the asset or liability is capable of being measured with sufficient reliability are identical to the reliability of measurement issues considered in the context of initial recognition.

CHOOSING A MEASUREMENT BASIS AND DECIDING WHETHER TO CHANGE IT

6.25 In choosing the measurement basis to be used for a particular category of assets or liabilities, the aim is to select the basis that is most appropriate bearing in mind:

(a) the objective of financial statements and the qualitative characteristics of financial information, in particular relevance and reliability;

(b) the nature of the assets or liabilities concerned; and

(c) the particular circumstances involved.

6.26 Although these factors may not change, the measurement basis that best meets them may. For example, measurement

bases that were once thought unreliable may become reliable.

MEASUREMENT ISSUES

Going concern

6.27 Financial statements are usually prepared - and measures are usually arrived at - on the basis that the reporting entity is a going concern because measures based on break-up values tend not to be relevant to users seeking to assess the entity's financial performance.

Discounting

6.28 Historical cost and replacement cost are both market prices and will therefore generally take into account the time value of money and the risk associated with the future expected cash flows.

6.29 To be consistent, these factors need also to be reflected in the other measures that can be used to determine the carrying amount of assets (in other words, value in use and net realisable value) and the carrying amount of any liabilities measured by reference to expected future cash flows. It follows that, when basing carrying amounts on future cash flows, those cash flows will need to be discounted.

6.30 The discount rate used will reflect the risks associated with the future expected cash flows involved (unless those future expected cash flows are already risk-adjusted) and the time value of money. As such it will reflect the risks specific to the item being measured but not the more general risks of the entity as a whole.

Arriving at a measure in the face of uncertainty

6.31 If uncertainty exists, the only way to determine an appropriate monetary amount for the asset or liability is

through the use of estimates. As long as a generally accepted estimation method is used and the measure is supported by a reasonable amount of confirmatory evidence – prudence requires a greater reliability of measurement for assets (and gains) than for liabilities (and losses) – the use of estimates is acceptable and will not prevent the measure from being sufficiently reliable to be used in the financial statements.

6.32 If the monetary amount at which an asset or liability is recognised is subject to significant uncertainty, the degree of uncertainty surrounding the estimate will usually be disclosed in order to avoid the impression that the outcome is certain. Such a disclosure might provide details of the significant assumptions and measurement basis used, the range of possible outcomes, and the principal factors that affect the outcome.

CAPITAL MAINTENANCE ADJUSTMENTS AND CHANGING PRICES

6.33 General price changes can affect the significance of reported surpluses/deficits and of residual interest. If this problem is acute, an approach will need to be adopted that involves recognising surpluses/deficits only after adjustments have been made to maintain the purchasing power of the entity's financial capital.

6.34 Specific price changes can affect the significance of reported surpluses/deficits and financial position. If the problem is acute, it will be necessary to adopt a system of accounting that informs the user of the significance of specific price changes for the entity's financial performance and financial position.

CHAPTER 7:

PRESENTATION OF FINANCIAL INFORMATION

Good presentation ensures that the essential messages of the financial statements are communicated clearly and effectively and in as simple and straightforward a manner as possible. This chapter explains what good presentation entails. It also considers the information that often accompanies financial statements and explains some of the roles fulfilled by such information.

PRINCIPLES

- Financial statements comprise primary financial statements and supporting notes that amplify and explain the primary financial statements. The primary financial statements themselves comprise the statement of financial performance*, the statement of financial position or balance sheet, and the cash flow statement.

- The presentation of information on financial performance focuses on the components of that performance and on the characteristics of those components.

- The presentation of information on financial position focuses on the types and functions of assets and liabilities held and on the relationships between them.

- The presentation of cash flow information will show the extent to which the entity's various activities generate and use cash, and will distinguish in particular between

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* *Although many entities in the UK and the Republic of Ireland at present prepare two statements of financial performance, the number of statements prepared is a matter of convention and legal requirement; no significant financial reporting principle is involved. For simplicity, however, the Statement generally refers to 'the statement of financial performance'.*

those cash flows that result from operations and those that result from other activities.

- Disclosure of information in the notes to the financial statements is not a substitute for recognition and does not correct or justify any misrepresentation or omission in the primary financial statements.

EXPLANATION

There are few fundamental differences between the principles and explanation relevant to profit-oriented entities, as expressed in Chapter 7 of the Statement, and their interpretation for public benefit entities. Therefore much of what follows is a summary of the discussion in Chapter 7 of the Statement, which should be referred to for a full understanding. Additional explanation specific to public benefit entities has been added covering presentation in the balance sheet and accompanying information.

PRESENTATION OF INFORMATION IN FINANCIAL STATEMENTS

Clear, effective and simple communication

7.1 As financial statements are a means of communication, the objective of the presentation adopted is to communicate clearly and effectively and in as simple and straightforward a manner as is possible without loss of relevance or reliability and without unnecessarily increasing the length of the financial statements.

Highly structured and aggregated

7.2 The presentation of information in financial statements involves a high degree of interpretation, simplification, abstraction and aggregation - in other words, a loss of detailed information. Nevertheless, if this process is carried out in an orderly manner, greater knowledge will result because such a presentation will:

(a) convey information that would otherwise have been obscured;

(b) highlight those items, and relationships between items, that are generally of most significance;

(c) facilitate comparability between different entities' financial statements; and

(d) be more understandable to users.

7.3 The primary focus of the financial statements of public benefit entities is to provide information to assist with accountability for the efficient and effective use of funds. This focus is met through a set of interrelated reports (known as the primary financial statements) on:

(a) financial performance (the operating cost statement and the statement of total recognised gains and losses are examples of financial performance statements);

(b) financial position (the balance sheet); and

(c) cash inflows and outflows (the cash flow statement),

and a series of supporting disclosures (the notes to the financial statements).

7.4 The notes and primary financial statements form an integrated whole, with the notes amplifying and explaining the statements by, for example, providing:

(a) more detailed information on items recognised in the primary financial statements;

(b) context for, or an alternative view of, items recognised in the primary financial statements;

(c) relevant information that it is not practicable to incorporate in the primary financial statements, for example because of pervasive uncertainty.

7.5 The notes to the financial statements, therefore, represent a very important part of the overall information package. Nevertheless, disclosure of information in the notes is not a substitute for recognition and does not correct or justify any misrepresentation in, or omission from, the primary financial statements.

Classification

7.6 In order to facilitate the analysis of the information provided, items that are similar are presented together in the financial statements and distinguished from dissimilar items.

GOOD PRESENTATION

Statement of financial performance

7.7 The financial performance of a reporting entity is made up of components that exhibit differing characteristics in terms of, for example, nature, cause, function, relative continuity or recurrence, stability, risk, predictability and reliability. Information on financial performance needs to be presented in a way that focuses attention on these components and on their key characteristics.

7.8 Good presentation of financial performance information typically involves:

(a) recognising only gains and losses in the statement of financial performance.

(b) classifying components by reference to a combination of function (such as administrative) and of the nature of the item (such as employment costs).

(c) distinguishing amounts that are affected in different ways by changes in economic conditions or business activity (for example, by providing segmental information).

(d) identifying separately:

- items that are unusual in amount or incidence judged by the experience of previous periods or expectations of the future.
- items that have special characteristics, such as financing costs and taxation.
- items that are related primarily to the results of the future, rather than current, accounting periods, such as some research and development expenditure.

7.9 Gains and losses are generally not offset in presenting information on financial performance. However, gains and losses will be offset if:

(a) they relate to the same event or circumstance; and

(b) disclosing the gross components is not likely to be useful for an assessment of either future results or the effects of past transactions and events.

Balance Sheet

7.10 In assessing the financial position of an entity, users are most interested in the types and amounts of assets and liabilities held and the relationship between them, and in the function of the various assets. Information on the reporting entity's financial position therefore needs to be presented in a way that focuses attention on these aspects. Good presentation typically involves:

(a) recognising only assets, liabilities and residual interest in the balance sheet;

(b) delineating the entity's resource structure (major classes and amounts of assets) and its financial structure (major classes and amounts of liabilities and residual interest);

(c) distinguishing assets by function. For example, assets held for sale will be reported separately from assets held on a continuing basis for use in the entity's activities.

7.11 In presenting information on the reporting entity's assets, it is necessary that the amount and nature of assets* that are subject to legal restrictions over their application are disclosed and explained.

7.12 In presenting information on the reporting entity's financial position, assets will not be offset against liabilities.

7.13 For some public benefit entities there may also be some focus on the presentation of different types of residual interests, for example of the extent to which restricted (including endowment) funds exist. Where, as noted in paragraph 7.11, legal restrictions exist over the application of assets, it should be clear how the relevant amount is reflected in the residual interest as well as in the assets themselves.

Cash flow statement

7.14 Cash flow information will be of most use if it shows the extent to which the entity's activities generate and use cash, distinguishing in particular cash flows that are the result of operations from cash flows that result from other activities.

ACCOMPANYING INFORMATION

7.15 Financial statements are often accompanied and complemented by information that does not form part of

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* *In some cases the assets might constitute a portfolio that, at times, includes liabilities. The disclosure requirements would also apply to any liabilities within such a portfolio.*

the financial statements. Examples of such information include trend information, operating and financial reviews, reports from the entity's governing body (eg directors' report, trustees' report) and statements by the chief executive and key performance indicators, such as information on waiting lists, cost of refuse collection per household, and indicators of a charity's performance. The Statement refers to such information as accompanying information.

7.16 The primary objective of public benefits entities is to provide goods or services for the general public or social benefit. Therefore, the accompanying information is often of high importance for users of such entities' financial statements in assessing the performance of an entity as a whole.

7.17 Although accompanying information generally has the same objective as financial statements, it usually comprises a different kind of information (some of the accompanying information deals with matters that are not in the financial statements and some deals with matters that are in the financial statements, but from a different perspective). For example, it often includes:

(a) narrative disclosures describing and explaining the entity's activities;

(b) historical summaries and trend information;

(c) non-accounting and non-financial information; and

(d) evolutionary or experimental disclosures that are not considered suitable for inclusion in the financial statements.

7.18 The more complex entities become, the more users need an objective and comprehensive analysis and explanation of the main features underlying their financial performance and financial position. Such disclosures are best presented in the

context of a discussion of the entity's business as a whole. This may include a discussion of what the residual interest represents and, where appropriate, management's future intentions regarding the net assets the residual interest represents.

Comparison to budget

7.19 Many funders and financial supporters will be interested in the extent to which actual expenditure compares to that forecast, for example where it is used to determine the extent of a compulsory levy. In addition, where a grant has been provided, the provider will be interested in the extent to which it covered the associated expenditure.

7.20 As a result it may be useful to provide information on a comparison to budget, or an outturn position for grants, within general purpose financial reports, as part of the accompanying information. However, in providing such information it is necessary to ensure that, for example:

(a) the information provided is of general use and not solely regulatory (or special purpose);

(b) the information is provided at an appropriate level of detail or aggregation (such that it is useful, understandable and not so voluminous as to mask key messages).

HIGHLIGHTS AND SUMMARY INDICATORS

7.21 Financial statements and accompanying information sometimes include amounts, ratios, and other computations that attempt to distil key information about the reporting entity's financial performance and financial position. Such highlights and summary indicators cannot, on their own, provide a basis for meaningful analysis or prudent decision-making. It is therefore essential that they are not presented in a way that exaggerates their importance.

7.22 However, well-presented highlights and summary indicators are useful to some users, who perhaps only require very basic information, or plan to use that information to identify areas to analyse further.

7.23 Notwithstanding the limitations of highlights and summary indicators, if such information is provided it needs to be presented in a manner and context that enable its meaning to be communicated to users. This will often entail explaining the reasons for changes in the relative or absolute size of the figures from one period to the next.

CHAPTER 8:

ACCOUNTING FOR INTERESTS IN OTHER ENTITIES

Financial statements need to reflect the effect on the reporting entity's financial performance and financial position of its interests in other entities. This involves various measurement and presentation issues. Rather than being dealt with in the relevant chapters and therefore in isolation from each other, they are dealt with together in this chapter. For similar reasons, various consolidation issues are dealt with in this chapter.

PRINCIPLES

- Single entity financial statements and consolidated financial statements present the interests the reporting entity may have in other entities from different perspectives.

- In single entity financial statements, interests in other entities are dealt with by focusing on the income and/or expenditure and (depending on the measurement basis adopted) capital growth arising from those interests.

- In consolidated financial statements, the way in which interests in other entities are dealt with depends on the degree of influence involved.

  (a) An interest that involves control of another entity's operating and financial policies is dealt with by incorporating the controlled entity as part of the reporting entity.

  (b) An interest that involves joint control of, or significant influence over, another entity's operating and financial policies is dealt with by recognising the reporting entity's share of that other entity's results and resources in a way that does not

involve showing those results and resources in the performance statement and balance sheet as if they were controlled by the reporting entity.

(c) Other interests are dealt with in the same way as any other asset.

- Although consolidated financial statements are the financial statements of the group as a whole, they are prepared from the perspective of the parent and, as a result, ultimately focus on the parent's interest in its subsidiaries. The effect on benefit flows of any outside interest in the subsidiaries will therefore be separately identified.

- Consolidated financial statements reflect the whole of the parent's investment in its subsidiaries, including, where applicable, purchased goodwill.

- A transaction involving the amalgamation of two or more reporting entities is reflected in the consolidated financial statements in accordance with its character. Therefore, a transaction that is of the character of:

  (a) an acquisition is reflected in the consolidated financial statements as if the acquirer purchased the acquiree's assets and liabilities as a bundle of assets and liabilities on the open market.

  (b) a merger is reflected in the consolidated financial statements as if the new reporting entity, comprising all the parties to the transaction, had always existed.

EXPLANATION

There are few fundamental differences between the principles and explanation relevant to profit-oriented entities, as expressed in Chapter 8 of the Statement, and their interpretation for public benefit entities. Therefore much of what follows is a summary of the discussion in Chapter 8 of the Statement, which should be referred

to for a full understanding. Additional explanation specific to public benefit entities has been added covering business combinations.

DEGREE OF INFLUENCE

8.1 Although an entity's interest in a second entity may take many different forms, the key factor in determining its effect on the first entity's financial performance and financial position is the degree of influence it exerts over the operating and financial policies of the second entity involved.

8.2 The highest degree of influence that an entity can have is control. As Chapter 2 explains, control comprises the ability to deploy the economic resources involved and to benefit (or to suffer) by their deployment. Other degrees of influence have these same aspects; in effect, the ability to influence the activities of the entity with a view to gaining economic benefits from that influence.

8.3 Although it is possible to classify the degree of influence that an entity has over another entity in an almost infinite number of ways, it is sufficient for the purposes of the Statement to classify it as follows:

(a) *Control* - where one entity controls another entity.

(b) *Joint control* - where the entity does not itself control the other entity, but shares control through some form of arrangement jointly with others.

(c) *Significant influence* - where the entity has neither control nor joint control, but exerts a degree of influence over the entity's operating and financial policies that is at the least a significant influence and at the most just short of control.

(d) *Lesser or no influence* - where any influence that the entity has over the entity's operating and financial policies is less than a significant influence.

REFLECTING THE EFFECTS OF INTERESTS IN OTHER ENTITIES

Consolidated financial statements and single entity financial statements

8.4 The effect on the entity's financial performance and financial position of an interest in an entity is reflected in the first entity's financial statements in different ways depending on the type of financial statements being prepared.

(a) Financial statements of a reporting entity whose boundary has been drawn by reference to the scope of its direct control - single entity financial statements - take a narrow view of the reporting entity's interests in other entities and reflect only the income and capital growth arising from those interests.

(b) Financial statements of a reporting entity whose boundary has been drawn by reference to the scope of the entity's control (both direct and indirect) - consolidated financial statements - present an expanded view of the reporting entity's interests in other entities that reflects the reporting entity's influence over, and its accountability for, the activities and resources of these entities.

Interests involving control

8.5 If an entity controls one or more other entities, the controlling entity (the parent) and the controlled entities (the subsidiaries) will be a reporting entity (the group). The group's financial statements (consolidated financial statements) are prepared by aggregating the gains, losses, assets, liabilities and cash flows of the parent and its subsidiaries. This ensures that the effects on the parent's financial performance and financial position of its interests in its subsidiaries are fully reflected in the financial statements.

Interests involving joint control or significant influence

8.6 If the reporting entity shares joint control of, or exercises significant influence over, another entity, it will be directly involved in and affected by that other entity's activities. Its interest is therefore reflected in the consolidated financial statements in a way that:

(a) recognises the reporting entity's share of the results and net assets of the investee; and

(b) does not misrepresent the extent of its influence over the investee - in other words, it does not treat activities and resources that are not controlled by the reporting entity as if they are controlled by the reporting entity.

Interests involving lesser or no influence

8.7 If the reporting entity's influence does not involve control, joint control or significant influence, the reporting entity will not be accountable for the entity's activities. In such circumstances, the only amounts recognised in the consolidated financial statements will be the investment (if any) and any income derived therefrom.

CONSOLIDATED FINANCIAL STATEMENTS

8.8 The gains, losses, assets, liabilities and cash flows of all subsidiaries are reflected in full in the consolidated financial statements, even if a subsidiary is not wholly-owned. This reflects the parent's ability, through its control, to deploy both its own economic resources and those of its subsidiaries even where it does not wholly own the subsidiaries.

8.9 This Chapter separates general purpose financial statements into single entity financial statements and consolidated financial statements; such distinctions are not necessarily observed in regulatory requirements, which may require combined financial statements for a number of entities that do not meet the criteria for a reporting entity. An example

would be financial statements showing the combined results of related initiatives where different elements may be carried out by different entities.

ACCOUNTING FOR BUSINESS COMBINATIONS

8.10 An amalgamation of two or more reporting entities – sometimes referred to as a business combination – can take a number of different forms. All these forms can be characterised as either:

(a) a purchase (for public benefit entities potentially 'a gift') – such transactions are commonly referred to as acquisitions*; or

(b) a uniting of interests – such transactions are commonly referred to as mergers.

8.11 An acquisition is a business combination that is in the nature of an acquisition by one entity of another entity (ie one entity is the acquirer). The transaction therefore results in an existing reporting entity being enlarged and is reflected in the consolidated financial statements by treating the assets and liabilities of the entity acquired and the purchased goodwill as if the transaction was the purchase of a bundle of assets and liabilities on the open market.

8.12 On the other hand, a merger is in the nature of a coming together of two entities to form a new reporting entity. This is reflected in the financial statements of the new reporting entity comprising all the parties to the transaction as if that entity had always existed. As a result, the assets and liabilities of each party to the transaction are treated as if they were acquired by the new reporting entity at the time that they

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* *An acquisition is something that has been acquired by any means and therefore includes something that has been gifted as well as something that has been purchased.*

were acquired by the party concerned*: none of the assets or liabilities is treated as being purchased at the time of the business combination as part of a bundle of assets and liabilities on the open market.

8.13 The fact that a business combination involves public benefit entities does not of itself influence whether the business combination is accounted for as an acquisition or a uniting of interests. For public benefit entities, similarly to profit-oriented entities, true mergers do occur, but after a full analysis of the circumstances it is likely that the majority of business combinations (other than those involving entities under common control†) will be acquisitions. This is because it will be possible to identify an acquirer, for example by relative size or by one entity dominating the governing body and/or management structure, and as a result the entity existing after the combination is an enlarged version of one of the combining entities, not a new entity. It is important that for each business combination that occurs the facts of the individual circumstances are considered to determine whether the combination is an acquisition or a merger.

8.14 Business combinations involving public benefit entities often do not involve consideration and are both legally, and in substance, a "gift" of one business to another. Therefore, it might be necessary to adopt an alternative presentation to

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* *This description of 'merger accounting' has been repeated from the Statement. However, although the Board continues to believe that there can be circumstances where a business combination does not have the characteristics of an acquisition, merger accounting has generally lost favour as a means of faithfully representing the economic substance of the combination that has occurred. In substance, it can be argued that a new entity has been created from the date of the business combination, which acquired the combined assets on that date. A more suitable presentation might be for all the assets and liabilities to be treated as if they were acquired on the open market on the date the combination took place.*

† *At present, accounting standards require combinations involving entities under common control to be accounted for as mergers providing certain criteria are met. In July 2005 the ASB issued an Exposure Draft proposing to converge with international standards that do not permit an alternative to acquisition accounting and do not include group reconstructions within their scope.*

the recognition of goodwill in the consolidated financial statements.

8.15 Where a business combination is in substance a gift of one business to another:

(a) the excess of the fair value of the assets acquired over the fair value of the liabilities assumed should be treated as a gain. The gain represents the gift of the value of one business to another;

(b) if the fair value of the liabilities assumed exceeds the fair value of the assets acquired, the deficit of the fair value of the liabilities in comparison to the assets should be treated as a loss. The loss represents the net obligations assumed, for which the acquiring entity has not received a financial reward, which will therefore result in a decrease in residual interest.

8.16 Where a business combination is not in substance a gift, for example if it involves a public benefit entity acquiring a profit-oriented entity for consideration it should be accounted for as if both parties to the combination were profit-oriented entities.

APPENDIX 1 –

THE PRINCIPLES THAT HAVE BEEN RE-EXPRESSED

1 Many of the principles within this proposed Interpretation are exactly the same as those that are relevant to profit-oriented entities. Those that have been amended or inserted are as follows:

Principle as expressed in the Statement of Principles for Financial Reporting	**Principle as re-expressed in this proposed Interpretation**	**Discussion**
Chapter 1 • That objective can usually be met by focusing exclusively on the information needs of present and potential investors, the defining class of user.	• That objective can usually be met by focusing exclusively on the information needs of funders and financial supporters, the defining class of user.	Amended to reflect a different defining class of user.
Chapter 1 • Present and potential investors need information about the reporting entity's financial performance and financial position that is useful to them in evaluating the entity's ability to generate cash (including the timing and certainty of its generation) and in assessing the entity's financial adaptability.	• Funders and financial supporters need information about the reporting entity's financial performance and financial position that is useful to them in helping to evaluate the proper and efficient use of the entity's resources and in assessing the entity's cash needs and its financial adaptability.	Amended to reflect a different defining class of user and a slightly different emphasis on the use of the information.

Principle as expressed in the Statement of Principles for Financial Reporting	Principle as re-expressed in this proposed Interpretation	Discussion
Chapter 3 • Information is relevant if it has the ability to influence the economic decisions of users and is provided in time to influence those decisions.	• Information is relevant if it has the ability to influence the economic decisions of users, or their assessment of the effectiveness of the stewardship of management, and is provided in time to influence those decisions or assessments.	Amended to include reference to the use of information in assessing the effectiveness of the stewardship of management.
Chapter 3 • Information is material to the financial statements if its misstatement or omission might reasonably be expected to influence the economic decisions of users.	• Information is material to the financial statements if its misstatement or omission might reasonably be expected to influence the economic decisions of users, or their assessment of the effectiveness of the stewardship of management.	Amended to include reference to the use of information in assessing the effectiveness of the stewardship of management.

Principle as expressed in the Statement of Principles for Financial Reporting	**Principle as re-expressed in this proposed Interpretation**	**Discussion**
Chapter 4 • The elements of the financial statements are: (a) assets; (b) liabilities; (c) ownership interest; (d) gains; (e) losses; (f) contributions from owners; (g) distributions to owners.	• The elements of the financial statements are: (a) assets; (b) liabilities; (c) residual interest; (d) gains; (e) losses; (f) contributions establishing a financial interest in the residual interest; (g) distributions to holders of a financial interest in the residual interest.	Amended due to the different nature of owners and financial interests in the context of public benefit entities.
Chapter 4 • Ownership interest is the residual amount found by deducting all of the entity's liabilities from all of the entity's assets.	• Residual interest is the amount found by deducting all of the entity's liabilities from all of the entity's assets.	Amended due to the different nature of owners in public benefit entities.
Chapter 4 • Gains are increases in ownership interest not resulting from contributions from owners.	• Gains are increases in residual interest not resulting from contributions establishing a financial interest in the residual interest.	Amended due to the different nature of owners' financial interests in the context of public benefit entities.
Chapter 4 • Losses are decreases in ownership interest not resulting from distributions to owners.	• Losses are decreases in residual interest not resulting from distributions to holders of a financial interest in the residual interest.	Amended due to the different nature of owners and financial interests in the context of public benefit entities.

Principle as expressed in the Statement of Principles for Financial Reporting	**Principle as re-expressed in this proposed Interpretation**	**Discussion**
Chapter 4 • Contributions from owners are increases in ownership interest resulting from transfers from owners in their capacity as owners.	• Contributions establishing a financial interest in the residual interest are increases in residual interest resulting from transfers from parties that establish a financial interest in that residual interest.	Amended due to the different nature of owners and financial interests in the context of public benefit entities.
Chapter 4 • Distributions to owners are decreases in ownership interest resulting from transfers to owners in their capacity as owners.	• Distributions to holders of a financial interest in the residual interest are decreases in residual interest resulting from transfers to parties holding a financial interest in that residual interest in their capacity as holders of a financial interest.	Amended due to the different nature of owners and financial interests in the context of public benefit entities.
Chapter 5	• In a transaction involving the receipt of resources not related directly to the provision of goods or services, the recognition criteria described above will be met when there is clear evidence of a right to receive the resources.	New principle relating to the receipt of resources other than for net gain.

Principle as expressed in the Statement of Principles for Financial Reporting	Principle as re-expressed in this proposed Interpretation	Discussion
Chapter 8 • In single entity financial statements, interests in other entities are dealt with by focusing on the income and (depending on the measurement basis adopted) capital growth arising from those interests.	• In single entity financial statements, interests in other entities are dealt with by focusing on the income and/or expenditure and (depending on the measurement basis adopted) capital growth arising from those interests.	Amended to include reference to expenditure, because the entity might be contributing to the interest, rather than receiving income from it.
Chapter 8 • Consolidated financial statements reflect the whole of the parent's investment in its subsidiaries, including purchased goodwill.	• Consolidated financial statements reflect the whole of the parent's investment in its subsidiaries, including, where applicable, purchased goodwill.	Amended because purchased goodwill may arise only rarely.

APPENDIX 2 –

COMPARISON TO MATERIAL IN THE STATEMENT

1 The following table compares the material that is included in this proposed Interpretation with that in the Statement in order to provide an indication of which material:

(a) is the same, or substantially the same as the Statement;

(b) from the Statement has been omitted, but is equally relevant to public benefit entities;

(c) has been inserted specifically to address the circumstances of public benefit entities.

2 The table does not consider the principles themselves, which are addressed in Appendix 1.

Chapter	Comparison with the Statement
Introduction	*Purpose* Paragraphs 1 and 3 are substantially the same as paragraphs 1 to 4 of the Statement. Paragraphs 2 and 4 are additional. *Status* Paragraph 5 is the same as paragraph 5 of the Statement. Paragraphs 6 and 7 are additional. *Scope* Paragraphs 8 to 15 replace paragraph 9 of the Statement. Paragraphs 16 to 20 are substantially the same as paragraphs 6 to 8 of the Statement, although paragraphs 18 and 19 include a significant amount of new material. *True and fair* Paragraphs 10 to 13 of the Statement have not been repeated. *The standard-setting process* Most of paragraphs 14 to 17 of the Statement have not been repeated, but paragraph 15(a) is reflected in paragraph 21 of this proposed Interpretation.

Chapter	Comparison with the Statement
	Revisions to the statement Paragraph 22 is substantially the same as paragraph 18 of the Statement.
Chapter 1	*The objective of financial statements* Paragraph 1.1 is a summarisation of paragraphs 1.1 and 1.2 of the Statement. Paragraphs 1.2 to 1.4 expand on paragraphs 1.3 and 1.4 of the Statement. Paragraphs 1.5 and 1.6 are additional. Paragraphs 1.5 to 1.7 of the Statement have not been repeated, although paragraph 1.7 provides a brief summary. Paragraph 1.8 summarises paragraphs 1.8 and 1.9 of the Statement. Paragraphs 1.9 and 1.10 are additional. *Defining class of user* Paragraph 1.11 is substantially the same as paragraph 1.11 of the Statement. Paragraphs 1.10 and 1.12 of the Statement have not been repeated. Paragraphs 1.12 to 1.16 are additional. *Information required [by the defining class of user]* Paragraphs 1.17 to 1.23 summarise paragraphs 1.13 to 1.22 of the Statement with added public benefit entity context.
Chapter 2	*Entities that should prepare and publish financial statements* Paragraphs 2.1 to 2.3 are the same as the Statement. *The boundary of a reporting entity* Paragraphs 2.4 to 2.6 summarise paragraphs 2.4, 2.6 and 2.7 of the Statement; paragraph 2.5 has not been repeated. *What is control?* Paragraph 2.7 is the same as paragraph 2.8 in the Statement. Paragraph 2.8 repeats part of paragraph 2.10 in the Statement. Paragraph 2.9 has not been repeated. *Controlling an entity* Paragraphs 2.9 to 2.16 summarise paragraphs 2.11 to 2.20 of the Statement. *Assets under an entity's stewardship but not control* Paragraph 2.17 is additional.

Chapter	Comparison with the Statement
Chapter 3	*Relevance* Paragraph 3.1 is the first sentence of paragraph 3.1, and paragraph 3.2 of the Statement. Paragraph 3.2 is the first part of paragraph 3.3 and paragraph 3.5 of the Statement. The remainder of paragraphs 3.1 and 3.3 and paragraph 3.4 in the Statement are not repeated. Paragraph 3.3 is substantially the same as paragraph 3.6 in the Statement. Paragraph 3.4 is additional. *Reliability* Paragraph 3.5 is the same as paragraphs 3.7 and 3.8 in the Statement. Paragraph 3.6 is the same as paragraph 3.12 in the Statement. Paragraph 3.7 is the first sentence of paragraph 3.13 and paragraph 3.14 in the Statement. Paragraph 3.8 is the same as paragraph 3.15 in the Statement. Paragraphs 3.10, 3.11, the remainder of 3.13 and 3.16 to 3.20 of the Statement have not been repeated. *Comparability* Paragraph 3.9 is substantially the same as paragraph 3.21 in the Statement. Paragraph 3.10 summarises paragraph 3.23 in the Statement. Paragraph 3.11 summarises paragraph 3.24 in the Statement. Paragraphs 3.22 and 3.25 have not been repeated. *Understandability* Paragraph 3.12 summarises paragraphs 3.26 and 3.27 in the Statement. Paragraphs 3.13 and 3.14 are additional. *Materiality* Paragraphs 3.15 to 3.19 are substantially the same as paragraphs 3.28 to 3.32 in the Statement. *Constraints on the qualitative characteristics* Paragraph 3.20 is the same as paragraph 3.33 in the Statement. Paragraph 3.21 is a summary of paragraph 3.34 in the Statement, as is paragraph 3.22 of 3.36 in the Statement and paragraph 3.25 of paragraph 3.37 in the Statement. Paragraph 3.35 of the Statement has not been repeated. Paragraphs 3.23 and 3.24 are additional.
Chapter 4	*The elements of financial statements* Paragraphs 4.1 and 4.2 are substantially the same as paragraphs 4.1 and 4.2 in the Statement. Paragraphs 4.3 and 4.4 of the Statement have not been repeated. Paragraph 4.3 is the same as the second sentence of paragraph 4.5 in the Statement.

Chapter	Comparison with the Statement
	Assets The definition is the same as paragraph 4.6 in the Statement. Paragraph 4.4 is the same as paragraph 4.8 in the Statement. Paragraph 4.5 summarises paragraphs 4.9 and 4.10 in the Statement. Paragraph 4.6 is the same as paragraph 4.11 in the Statement. Paragraph 4.7 is substantially the same as paragraph 4.13 in the Statement. Paragraph 4.13 is substantially the same as paragraph 4.17 in the Statement. Paragraphs 4.17 and 4.18 summarise paragraphs 4.19 and 4.20 in the Statement. Paragraph 4.19 is the first sentence of paragraph 4.22 in the Statement. Paragraphs 4.8 to 4.12 and 4.14 to 4.16 are additional. Paragraphs 4.7, 4.12, 4.14 to 4.16, 4.18 and 4.21 of the Statement have not been repeated. *Liabilities* The definition is the same as paragraph 4.23 in the Statement. Paragraphs 4.20 to 4.22 are the same as paragraphs 4.24 to 4.26, except that paragraph 4.22 includes some additional material. Paragraph 4.23 is the same as paragraph 4.27 in the Statement. Paragraph 4.26 is the same as paragraph 4.29 in the Statement. Paragraph 4.27 is the first part of paragraph 4.30 in the Statement. Paragraphs 4.29 and 4.30 summarise paragraphs 4.31 and 4.32 in the Statement. Paragraphs 4.24, 4.25, 4.28, and 4.31 to 4.42 are additional. Paragraph 4.28 of the Statement has not been repeated. *Offsetting rights and obligations* Paragraphs 4.43 to 4.46 are essentially the same as paragraphs 4.33 to 4.36 in the Statement, except that the sub-paragraphs of 4.33 have not been repeated. *Residual interest* Paragraph 4.47 reflects the public benefit entity context of paragraph 4.37 in the Statement. Paragraph 4.50 includes some of the material from paragraph 4.38 in the Statement. Paragraphs 4.48, 4.49, 4.51 and 4.52 are additional. *Gains and losses* The definition and paragraph 4.53 are substantially the same as paragraphs 4.39 and 4.40 in the Statement.

Chapter	Comparison with the Statement
	Paragraph 4.41 has not been repeated. Paragraphs 4.54 to 4.60 are additional. *Contributions establishing a financial interest in the residual interest* Paragraph 4.61 relates to paragraph 4.43 in the Statement. Paragraph 4.63 builds on paragraph 4.44 in the Statement, providing additional public benefit entity context. Paragraphs 4.62 and 4.64 are additional. *Distributions to holders of a financial interest in the residual interest* Paragraph 4.65 is additional. The first sentence of paragraph 4.66 is the first sentence of paragraph 4.45 in the Statement.
Chapter 5	*The recognition process* Paragraphs 5.1 and 5.2 are the same as paragraphs 5.1 and 5.2 in the Statement. Paragraphs 5.3 to 5.6 summarise paragraphs 5.3 to 5.6 in the Statement. Paragraphs 5.7 to 5.10 are substantially the same as paragraphs 5.8, 5.9 and 5.11 in the Statement. Paragraphs 5.7 and 5.10 have not been repeated. *Initial recognition* Paragraph 5.10 is the same as paragraph 5.12 in the Statement. Paragraphs 5.11 and 5.12 summarise paragraphs 5.14 and 5.15 in the Statement. Paragraphs 5.13 and 5.14 are the same as paragraphs 5.16 and 5.17 in the Statement. Paragraph 5.16 is substantially the same as paragraph 5.19 in the Statement. Paragraph 5.15 is additional. Paragraphs 5.13 and 5.18 have not been repeated. Paragraph 5.17 is substantially the same as paragraph 5.20 and the first sentence of paragraph 5.21; the remainder of paragraph 5.21 has not been repeated. *Derecognition* Paragraphs 5.18 to 5.21 summarise paragraphs 5.22 to 5.25 in the Statement. *Revenue recognition* Paragraphs 5.22 to 5.25 summarise paragraphs 5.26 to 5.30 in the Statement. Paragraphs 5.26 to 5.28 are the same as paragraphs 5.33 to 5.35 in the Statement, except that the second sentence of paragraph 5.34 has not been

Chapter	Comparison with the Statement
	repeated. Paragraphs 5.31 and 5.32 have not been repeated. The first sentence of paragraph 5.29 is the same as the first sentence of paragraph 5.36 in the Statement, otherwise paragraphs 5.29 to 5.45 are additional.
Chapter 6	*Alternative bases of measurement* Paragraph 6.1 summarises paragraph 6.1 in the Statement. Paragraph 6.2 is the same as paragraph 6.3 in the Statement. Paragraph 6.3 is substantially the same as the first sentence of paragraph 6.4 in the Statement. Paragraphs 6.2 and 6.5 have not been repeated. *Alternative measures of current value* Paragraph 6.4 is substantially the same as paragraph 6.6 in the Statement. Paragraph 6.9 is based on paragraph 6.7 in the Statement. Paragraphs 6.5 to 6.8 and 6.10 to 6.12 are additional. Paragraph 6.13 is essentially the same as paragraph 6.9 in the Statement. *The measurement process* Paragraphs 6.14 to 6.19 are substantially the same as paragraphs 6.10 to 6.15 in the Statement, except that the sub-paragraphs of 6.14 have not been repeated. Paragraph 6.16 has not been repeated. Paragraphs 6.20 to 6.24 are substantially the same as paragraphs 6.17 to 6.22 in the Statement, except that paragraph 6.21 has not been repeated. *Choosing a measurement basis and deciding whether to change it* Paragraph 6.25 is the same as paragraph 6.23 in the Statement. Paragraph 6.26 is the same as the first part of paragraph 6.24 in the Statement. Paragraphs 6.25 to 6.29 have not been repeated. *Measurement issues* Paragraph 6.27 is substantially the same as paragraph 6.30 in the Statement. Paragraph 6.28 is the same as part of paragraph 6.32 in the Statement. Paragraphs 6.29 and 6.30 are the same as paragraphs 6.33 and 6.34 in the Statement. Paragraph 6.31 is the same as paragraph 6.36 in the Statement. Paragraph 6.32 is the same as paragraph 6.38 in the Statement. Paragraphs 6.31, 6.35, 6.37 have not been repeated.

Chapter	Comparison with the Statement
	Capital maintenance adjustments and changing prices Paragraphs 6.33 and 6.34 are the same as the sub-paragraphs of 6.42 in the Statement. Paragraphs 6.39 to 6.41 have not been repeated.
Chapter 7	*Presentation of information in financial statements* Paragraphs 7.1 to 7.6 are the same, or substantially the same, as paragraphs 7.1 to 7.6 in the Statement. Paragraphs 7.7 and 7.8 have not been repeated. *Good presentation* Paragraphs 7.7 to 7.12 summarise paragraphs 7.9 to 7.13 in the Statement, except that paragraph 7.11 is additional. Paragraph 7.13 is additional. Paragraph 7.14 summarises paragraph 7.14 in the Statement. *Accompanying information* Paragraph 7.15 is substantially the same as paragraph 7.15 in the Statement. Paragraph 7.16 is additional. Paragraph 7.17 summarises paragraphs 7.16 and 7.17 of the Statement. Paragraph 7.18 summarises paragraph 7.18 in the Statement. Paragraphs 7.19 and 7.20 are additional. *Highlights and summary indicators* Paragraphs 7.21 to 7.23 are substantially the same as paragraphs 7.19 to 7.21 in the Statement.
Chapter 8	*Degree of influence* Paragraphs 8.1, 8.2 and 8.3 are the same as paragraphs 8.1, 8.3 and 8.4 in the Statement. Paragraph 8.2 has not been repeated. *Reflecting the effects of interests in other entities* Paragraph 8.4 is substantially the same as paragraph 8.5 in the Statement. Paragraph 8.5 is substantially the same as paragraph 8.7 in the Statement. Paragraph 8.6 is substantially the same as paragraph 8.9 in the Statement. Paragraph 8.7 is substantially the same as paragraph 8.10 in the Statement. Paragraphs 8.6 and 8.8 have not been repeated. *Consolidated financial statements* Paragraph 8.8 is the same as paragraph 8.11 in the Statement. Paragraph 8.9 is additional. Paragraphs 8.12 and 8.13 are not repeated.

Chapter	Comparison with the Statement
	Accounting for business combinations Paragraphs 8.10 to 8.12 are the same as paragraphs 8.14 to 8.16 in the Statement. Paragraphs 8.13 to 8.16 are additional.

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